Lectures on

CONTRACTS – II
(Special Contracts)

Preface to the Second Edition .....

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LECTURES ON CONTRACTS - II

(Special Contracts)

Lecture - I

INTRODUCTION

From the early morning till late night, i.e. from the time we get up from bed, till we go to the bed in the night, we enter into a number of transactions during the regular course of our life., and these transactions/activities directly or indirectly., expressly or impliedly result in contracts. For instance, for food, we enter into a contract with seller/supplier of the food/provisions of food viz. rice, wheat, oil, dals etc. Similarly, for shelter, we enter into a contract with seller/builder to purchase an independent house or a flat or a landlord/Lessor to get the residential accommodation on rent/lease. Similarly, for all our needs like health, education, entertainment etc. to satisfy our needs/requirements, we contact with other person/ persons/parties. Such contacts form basis to enter into an agreement (oral or written, express or implied) which ultimately result into a contract.

The law, which deals with contracts is called 'Law of Contracts' and is governed by the "Indian Contract Act, 1872". The Indian Contract Act was passed in 1872 and came into force from 1st September, 1872 (P.S. The law relating to transfer of movable property (goods) is governed by the Sale of Goods Act, 1930. Similarly, the law relating to transfer of immovable property (and also movable property) by Sale, Lease, Mortgage, Gift etc. between two living persons is governed by the Transfer of Property Act, 1882). It extends to the whole of India except the State of Jammu & Kashmir. At the time of passing, it contained 266 sections as detailed below –

1. Sections 1 to 75 deal with "General Principles".

2. Sections 76 to 123, which dealt with Sale of Goods, was repealed and replaced by the Sale of Goods Act, 1930.

3. Sections 124 to 147 deal with the two kinds of special contracts namely, the Contract of Indemnity and the Contract of Guarantee.

4. Sections 148 to 181 lay down the provisions relating to special contracts namely, the Contract of Bailment and the Contract of Pledge or Pawn.

5. Sections 182 to 238 deal with the Contract of Agency; and

6. Finally, sections 239 to 266, which dealt with the law relating to partnership were repealed and replaced by section 73 and Schedule II of the Indian Partnership Act, 1932.

The present subject 'Contract-II' which deals with 'Special Contracts' or 'Specific Contracts' contains the following topics -

I. The Indian Contract Act, 1872

   i) The Contracts of Indemnity and Guarantee (Sections 124 to 147)

   ii) The Contracts of Bailment and Pledge (Sections 148 to 181)

   iii) The Contract of Agency (Sections 182 to 238)

II. The Contract of Sale of Goods (The Sale of Goods Act, 1930)

III. The Contracts of Partnership (The Indian Partnership Act, 1932) and

IV. The Negotiable Instruments (The Negotiable Instruments Act, 1881).

A brief outline of the chapters/lectures in this work is stated hereunder -

1. Lecture I speaks about the present chapter containing the brief sketch of the subject dealing with the Special Contracts.

2. Lecture II deals with two types of Specific Contracts namely, the Contract of Indemnity and the Contract of Guarantee. Sections 124 to 147 of the Indian Contract Act, 1872 lay down the provisions relating to the Contracts of Indemnity and Guarantee. In a contract of indemnity, there are two parties namely indemnifier and the indemnity holder (or indemnified). In this contract, one party (indemnifier) promises the other party (indemnity holder/indemnified) to make good (or compensate) the loss caused to indemnified upon happening of an event. Eg. Fire insurance contract. In this contract, the insurance company undertakes to indemnify the loss and is called the "Indemnifier", while the owner of the property (whose loss on fire accident is to be indemnified) is called "the indemnified or the indemnity holder.

The other contract, which this chapter deals with, is the "Contract of Guarantee or the Contract of Suretyship". 'Guarantee' literally means "assurance given by one person to another at the default of some other". It is also known as the Contract of Suretyship. Section 126 of the Indian Contract Act, 1872 defines the Contract of Guarantee as "A contract to perform the promise or discharge the liability of a third person in case of default". The person who gives guarantee is called 'Surety' or 'Guarantor'. The person to whom the guarantee is given is called 'Creditor'. The person for whose default, the guarantee is given is called 'Principal Debtor'. Eg. 'A' advances a loan of Rs. 5000/- to 'B' against a promise by 'C' to repay in case of default by 'B'. It is a contract of Guarantee. In this example, 'A' is creditor, 'B' is Principal Debtor and 'C' is Surety or Guarantor.

This lecture contains the meaning and definition of the Contract of Indemnity and Guarantee., rights of the Indemnity holder and

Indemnifier., significance and extent of surety's liability., distinction between the contract of indemnity and guarantee and other aspects.

3. Lecture III deals with two types of the specific contracts namely, the contract of bailment and the contract of pledge. Sections 148 to 181 of the Indian Contract Act, 1872 lay down the provisions relating to the contracts of Bailment and Pledge. These two contracts are almost identical with some variations. In the contract of bailment, goods are delivered by one person (bailor) to the other (bailee) for a specific purpose. Whereas in the contract of Pledge, goods are delivered as a security to obtain a loan. "Bailment is the delivery of goods by one person to another for some purpose upon a contract, subject to certain terms and conditions for return or disposal, as directed after the purpose is accomplished". The person, who delivers goods is called 'Bailor'. The person to whom the goods are delivered is called 'Bailee'. Eg. 'A' delivers a cloth to 'B', a tailor for making a shirt. The contract between 'A' & 'B' is bailment. 'A' is a Bailor, and 'B' is a Bailee.

Pledge is a special kind of bailment. It is also known as 'Pawn'. If the goods are bailed as a security for payment of a debt or performance of a promise, it is called 'Pledge'. The person delivering the goods (Bailor) in this case is called 'Pledger' or 'Pawner'. The person to whom the goods are delivered (Bailee) is called the 'Pledgee' or 'Pawnee'.*Eg.* If a farmer delivers to the Bank 100 bags of wheat as security for obtaining a loan, it is called pledge. The farmer is called pledger or pawner. The Bank is called pledgee or pawnee.

This lecture covers meaning, definition and elements of the contracts of Bailment and Pledge., rights and duties of the Bailor and Bailee and of the Pledger(Pawner) and Pledgee(Pawnee)., Bailee's lien and other aspects.

4. Lecture IV deals with the Contract of Agency. The provisions relating to the contract of agency are enshrined under sections 182 to 238 of the Indian Contract Act, 1872. When a

person appoints another to act on his behalf with a third party, it is called 'Agency'. The person who appoints is called 'Principal'. The other person, who is appointed is called 'Agent'. The contract between them (i.e. Principal and Agent) is called 'Contract of Agency'. 'Agency is the legal relationship between an agent and Principal; to bring the principal into legal relationship with the third party.' Eg. 'A' appoints 'B' to purchase some property on his behalf. Here, 'A' is principal and 'B' is Agent. The relationship between 'A' and 'B' is called Agency.

This lecture covers the meaning and definition of agency., meaning and definition of Principal and Agent., Kinds of Agency., Delegation of authority., rights and duties of Agent., Foreign Principal., Undisclosed Principal., termination of agency etc.

5. Lecture V deals with the contracts relating to the sale of goods under the Sale of Goods Act, 1930. In a civilised society, transfer of property from one person to another is quite obvious. When a movable property is transferred from one living person to another living person (i.e. transfer inter vivos), the law applied is the Sale of Goods Act, 1930. In other words, the disputes relating to transfer of movable property between two living persons are governed/settled by the Sale of Goods Act, 1930. Before passing of the Act, the provisions relating to sale of goods were enshrined in Chapter-VII, containing Sections 76 to 123 of the Indian Contract Act, 1872. In this chapter, meaning, definition of Sale and Agreement to Sell., difference between Sale and Agreement to Sell., Conditions and Warranties., Implied Conditions and Warranties., Caveat Emptor., Right of Unpaid Vendor/Seller (Vendor's Lien)., Nemo dot quod non habet., Passing of Risk etc. are discussed.

6. Lecture VI deals with the contract of Partnership under the Indian Partnership Act, 1932. Partnership is a special kind of contract. Earlier, the law relating to partnership was governed by Chapter XI, containing Sections 239 to 266 of the Indian Contract Act, 1872. This chapter was repealed and replaced by a separate Act

called the "Indian Partnership Act" in 1932."When two or more persons (Subject to a maximum of 10 in Banking and 20 in Non-banking) carry on business to share profits and losses equally or in proportion of capitals, it is called partnership business." The persons are called 'Partners' and the business is called 'Partnership Firm'. "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all". This chapter contains the features of Partnership., Kinds of Partners., Partnership and Agency (The Rule in Cox vs. Hickman)., Registration of Firm and Effects of Non-Registration., Rights and Duties of Partners., Dissolution of Firm etc.

◈ 7. Lecture VII deals with negotiable instruments under the Negotiable Instruments Act, 1881. The law relating to negotiable instruments is governed by the 'Negotiable Instruments Act, 1881, which came into force from 1.3.1882. Negotiable Instrument means 'a piece of paper in writing entitling a right to the holder, a certain sum of money.' *Eg.* Cheque, Demand Draft, Promissory Note, Bill of Exchange, Share Warrants, Dividend Warrants, Bearer Debentures etc. The lecture covers Negotiable Instruments: Meaning, Definition and Kinds., Promissory Note., Bill of Exchange., Cheque., Distinction between Bill of Exchange and Cheque., Crossing of Cheques., Holder and Holder in Due Course., Negotiation., Kinds of Indorsement., Assignment and Negotiation etc.

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Lecture - II

CONTRACTS OF INDEMNITY AND GUARANTEE

Chapter VIII containing sections 124 to 147 of the Indian Contract Act, 1872 lays down the provisions relating to the Contracts of Indemnity and Guarantee. This lecture covers:

1. Contract of Indemnity
2. Rights of Indemnity holder
3. Contract of Guarantee
4. Distinction between Indemnity and Guarantee
5. Surety or Guarantor (Surety's Liability).
6. Co-Sureties
7. Continuing Guarantee
8. Discharge of Surety's Liability; and
9. Surety's Rights.

1. Contract of Indemnity

Meaning :— The term 'Indemnity' means 'promise to make good the loss'. According to dictionary meaning, indemnity is protection against loss, especially in the form of a promise to pay, or payment for loss of money, goods, etc. It is a security against, or compensation for loss, etc.

Definition (Sec. 124) : According to section 124 of the Indian Contract Act, 1872, contract of indemnity is - " a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a contract of indemnity".

Illustration : A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity.

Thus the scope of "indemnity" is by the very process of definition restricted to cases where there is a promise to indemnify against loss, caused : (a) by the promisor himself, or (b) by any other person. The definition excludes from its purview cases of loss arising from accidents like fire or perils of the sea. Loss must be caused by some human agency (***Gajanan Moreshwar v. Moreshwar Madan, (1942) 203 IC 261: AIR 1942 Bom 302: 44 Bom LR 703***). Contracts of insurance against loss are covered by the chapter on Contingent Contracts (***Tropical Insurance Co. v. Zenith Life Insurance, (1941) 196 IC 198(Lah)***.

The person making such promise is called *'indemnifier'*. The other person whose loss is to be indemnified is called *'Indemnity Holder* or *Indemnified'*.

Object : The main object of the contract of indemnity is to protect the promisee from loss or damage upon the happening of a contingency (uncertain event)

Adamson v. Jarvis (1827) 4 Bing 66: In this case, the plaintiff, an auctioner sold Cattle under instructions from the defendant. But, the defendant was not a real owner. The real owner proceeded against the auctioner. Then, the auctioner sued the defendant. Held that the suit is actionable, as a Contract of Indemnity.

Secretary of State v. Bank of India, AIR 1938 PC 191 : In this case, the Bank made a payment against forged Government promissory notes. In an action by the Government, the Bank was held liable under the Contract of Indemnity.It is to be noted that Section 124 recognises only such contract as a contrct of indemnity where there is a promise to save another person from loss which may be caused by the conduct of the promisor himself or by conduct

of any other person. It does not cover a promise to compensate for loss not arising due to human agency. Therefore, a contract of insurance is not covered by the definition of sec. 124. Thus, if under a contract of insurance, an insurer promises to pay compensation in the event of loss by fire, such a contract does not come within the purview of section 124. Such contracts are valid contracts, as being contingent contracts as defined in section 31.

United India Insurance Company v. M/s Aman Singh Munshilal, AIR 1994 P. & H. 206.: In this case the cover note stipulated delivery to the consigner. Moreover, on its way to the destination the goods were to be stored in a godown and thereafter to be carried to the destination. While the goods were in the godown, the goods were destroyed by fire. It was held that the goods were destroyed during transit, and the insurer was liable as per the insurance contract.

The position is different in England. Under English law, the word 'indemnity' carries a much wider meaning than given to it under the Indian Contract Act. It includes a contract to save the promisee from a loss, whether it be caused by human agency or any other event like an accident or fire. Under English law, a contract of insurance (other than life insurance) is a contract of indemnity.

Life insurance contract is, however, not a contract of indemnity. A contract of life insurance may provide the payment of a certain sum of money either on the death of a person, or on the expiry of a stipulated period of time (even if the assured is still alive). In such a case, the question of amount of loss suffered by the assured, or indemnity for the same, does not arise.

Indian Contract Act does not specifically provide that there can be an implied contract of indemnity. The Privy Council has, however, recognised an implied contract of indemnity also (***Secretary of State v. The Bank of India Ltd., AIR 1938 PC 191***).

The Law Commission of India in its 13th Report(1958) on Indian Contract Act, 1872, has recommended the amendment of section 124. According to its recommendation, "the definition of the 'Contract of Indemnity' in section 124 be expanded to include cases of loss caused by events which may or may not depend upon the conduct of any person. It should also provide clearly that the promise may also be implied.

2. Rights of Indemnity Holder or liability of indemnifier (Sec. 125)

Section 125 of the Indian Contract Act, 1872 deals with the "Rights of Indemnity Holder or the liability of Indemnifier". It runs as follows -

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor -

1. all damages, which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies (in simple words, to recover all damages of the subject matter).

2. all costs, which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit. (In simple words, to recover all incidental charges and costs of bringing or defending any suit, provided:

i) he acted under the authority of the indemnifier;

ii) did not act in contravention of the orders of the indemnifier; and

iii) acted in such a way as a prudent man would not act in a similar circumstance.)

3. to recover all sums, which he may have paid under the terms of any compromise of any such suit, if the compromise was

not contrary to the orders of the promisor and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit. (In simple words, to recover all sums paid by him for compromise of any such suit, if the compromise is within the purview of the contract of indemnity).

According to section 125 of the Indian Contract Act, 1872 an indemnity holder is entitled to recover the following amounts from the indemnifier, provided the indemnity holder must have acted within the scope of his authority.

1. He can recover all damages which he may be compelled to pay in any suit in respect of any matter to which indemnity has been given.

2. He is entitled to all costs which he is compelled to pay in bringing or defending any suit, provided (i) he acted under the authority of the indemnifier, (ii) did not act in contravention of the orders of the indemnifier and (iii) acted in such a way as a prudent man would act in a similar circumstance.

3. He can recover all sums which has been paid by him for a compromise of any such suit, if the compromise was within the purview of the contract of indemnity. The above said rights are the rights of an indemnity holder when sued. Besides those rights, he has other rights also.

Liability of Indemnifier : The extent of indemnity holder's right will be treated as the extent of indemnifier's liability under the contract of indemnity.

There had been a controversy as to the question, whether the indemnifier can be asked to indemnify before the indemnity holder has actually suffered the loss, or his liability arises only after the loss has been suffered by the indemnity holder.

According to English Common Law, no action could be brought against the indemnifier until the indemnity holder had suffered actual

English Law, "the right of the indemnity-holder should be more fully defined and the remedies of an indemnity-holder should be indicated even in cases where he has not been sued."

Thus, it is clear from the above that, Sec.125 confers on the indemnity holder the right to: i) recover all damages; ii) to recover all incidental charges and costs of the suit; and iii) to recover sums paid by him under compromise.

Rights of Indemnifier :— The Indian Contract Act, 1872 made no provision on this point. However, the rights of the indemnifier are the same as to that of the rights of the **'Surety'** in a Contract of Guarantee as laid down in Sections 140-147 of the Act.

3. Contract of Guarantee

Meaning :— The expression 'Guarantee' literally means "assurance given by one person to another at the default of some other". It is also known as the Contract of 'Suretyship'.

Definition :— Section 126 of the Indian Contract Act, defines the Contract of Guarantee as follows :

A 'contract of guarantee' is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives guarantee is called **'Surety'.** The person in respect of whose default the guarantee is given is called the **'Principal Debtor'** and the person to whom the guarantee is given is called the **'Creditor'**. The contract of guarantee may be either oral or written.

Eg:— A takes a loan from a bank. A promises to the bank to repay the loan. B also makes a promise to the bank saying that if A does not repay the loan "then I will pay". In this case, A is the principal debtor, who undertakes to repay the loan, B is the surety, whose liability is secondary because he promises to perform the same duty in case there is default on the part of A. The bank in whose favour the promise has been made is the creditor.

The object of a contract of guarantee is to provide additional security to the creditor in the form of a promise by the surety to fulfil a certain obligation, in case the principal debtor fails to do that.

In every contract of guarantee, there are three parties, the creditor, the principal debtor and the surety. There are three contracts in a contract of guarantee. Firstly, the principal debtor himself makes a promise in favour of the creditor to perform a promise. Secondly, the surety undertakes to be liable towards the creditor if the principal debtor makes a default. Thirdly, an implied promise by the principal debtor in favour of the surety that in case the surety has to discharge the liability on the default of the principal debtor, the principal debtor shall indemnify the surety for the same. When a borrower and a guarantor both sign an agreement in favour of a bank, they are jointly and severally liable under that contract.

The contract of guarantee is no doubt tripartite in nature but it is not necessary or essential that the principal debtor must expressly be a party to that document. In a contract of guarantee, the principal debtor may be a party to the contract by implication. Thus, there is possibility that a person may become a surety without the knowledge and consent of the principal debtor.

Essentials of the Contract of Guarantee:—

A contract of guarantee may be oral or in writing and must satisfy the conditions under Section 10 of the Indian Contract Act, 1872, and there must be three parties namely Principal Debtor, Surety and Creditor. In addition, the following requisites are to be satisfied to constitute a contract of guarantee :

i) Principal Debt and

ii) Consideration.

i) Principal Debt : In a contract of guarantee/suretyship one person (the surety) agrees to answer for some liability of another(the principal debtor) to a third person(the creditor). It is, therefore,

obvious that there must be a principal debt. There can be no contract of guarantee unless and until there is a principal debt.

ii) Consideration : According to section 127 of the Indian Contract Act 1872, anything done, or any promise made, for the benefit of principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

Illustrations :

a) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is a sufficient consideration for C's promise.

b) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.

c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

Thus where a loan is given or goods sold on credit on the basis of a guarantee that is sufficient consideration. Similarly, where a credit has already been given and the payment having become due, the creditor refrains from suing the principal debtor, that would be a sufficient consideration for giving a guarantee.

1. It may be oral or in writing and must satisfy the conditions under Section 10 of the Indian Contract Act, 1872.

2. There must be three parties namely Principal Debtor, Surety and the Creditor.

4. Distinction between the Contracts of Indemnity & Guarantee

Contract of Indemnity	Contract of Guarantee
1. There are two parties namely: i) Indemnifier; and ii) Indemnity Holder	1. There are three parties namely: i) Surety; ii) Creditor; and iii) Principal Debtor.
2. There is only one Contract i.e. between Indemnifier and Indemnity Holder.	2. There are three contracts i.e. between i) Surety and Creditor; ii) Principal Debtor and Surety, and iii) Creditor and Principal Debtor.
3. The liability of indemnifier arises on the happening of a contingency.	3. The liability of surety arises, if there is a default by principal Debtor.
4. The object or purpose of this contract is to reimburse the loss.	4. The object or purpose is to provide security to the creditor.
5. Stranger to Contract cannot sue. Indemnifier must always bring the suit in the name of indemnified and cannot sue third parties in his own name.	5. Stranger to Contract can sue. If the surety discharges the debt payable by the principal debtor he steps into the shoes of creditor and becomes entitled to realise the money paid in his own right.
6. The liability of indemnifier is primary and independent.	6. Surety's liability is collateral or secondary.

5. SURETY OR GUARANTOR
(Extent of Surety's Liability or "Surety is a favoured Debtor or the Liability of Surety is co-extensive with that of Principal Debtor)

Surety is also known as 'Guarantor'. Surety is one of the three parties in a Contract of Guarantee. Before explaining Surety's Liability, it is necessary to explain in brief the meaning and definition of the Contract of Guarantee.

Meaning :— The expression 'Guarantee' literally means "assurance given by one person to another at the default of some other". It is also known as the Contract of Suretyship.

Definition :— Section 126 of the Indian Contract Act defines the Contract of Guarantee as "A Contract to perform the promise or discharge the liability of a third person in case of default."

Surety's Liability :— Section 128 of the Indian Contract Act, deals with the nature and extent of surety's liability. It runs as follows -

"The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract."

Illustration :

A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable, not only for the amount of the bill, but also for any interest and charges which may have become due on it.

According to this section, the liability of Surety is co-extensive with that of the principal debtor. In other words, his liability is the same with that of principal debtor. Surety cannot be held liable for more than the amount, if there is an agreement to that effect. Eg. Suppose the amount of debt is Rs. 10,000/- Surety gives undertaking to the extent of Rs. 5,000/- Surety cannot be held liable for more

than Rs. 5,000/- in the event of default by Principal Debtor. The relevant cases on this point is -

Yerlagadda v. Devata China Yerakayya, A.I.R. 1966 A.P. 151 :

In this case, the bond executed by the surety limited his liability to the tune of Rs. 15,000/- with a stipulation that he might be liable to any amount that might be finally decreed. It was held that the respondent (surety) "had undertaken the liability only to the tune of Rs. 15,000/- and the clause rendering himself liable to any amount that might be finally decreed should be construed as meaning not exceeding Rs. 15,000/-."

Aditya Narayan Chauresia v. Bank of India, A.I.R. 2000 Pat. 222 :

In this case, it has been held by the Patna High Court that if the guarantors bind themselves upto a certain maximum limit their liability cannot go beyond that.

The liability of Surety arises, when there is a default on the part of the 'Principal Debtor'. The liability of Surety is secondary or collateral. (Exists side by side or contingent) However, the Creditor can sue the Surety first, unless there is an agreement to the contrary.

Creditor can sue the surety without exhausting remedies against the Principal Debtor:— The liability of surety is Joint and Several. The liability is joint in the sense, the Creditor can sue both the Principal Debtor and the Surety. The liability of Surety is several in the sense, the creditor can sue him alone, leaving the principal Debtor. If the Creditor sues both the Principal Debtor and the Surety, and obtains decree, the decree may be executed first against the Surety also. There is no hard and fast rule that the creditor should proceed first against the Principal Debtor and Surety later. The relevant leading case on this point was explained by the Supreme Court in *Bank of Bihar v. Damodar Prasad* as follows -

"Before payment, the surety has no right to dictate terms to the creditor and ask him to pursue his remedies against the principal in the first instance. In the absence of some special equity, the surety has no right to restrain an action against him by the creditor on the ground that the principal is solvent or that the creditor may have relief against the principal in some other proceedings.

Likewise, where the creditor has obtained a decree against the surety and the principal, the surety has no right to restrain execution against him until the creditor has exhausted his remedies against the principal."

***Bank of Bihar vs. Damodar Prasad* AIR 1969 SC 297:**

In the instant case, the plaintiff bank lent money to Damodar Prasad against the guarantee by Parasnath Sinha. Despite several reminders by the plaintiff neither Damodar Prasad (Principal debtor) nor Parasnath Sinha (the surety) repaid the loan. Then, the plaintiff Bank sued both the Principal Debtor and Surety. The Court passed decree in favour of the Plaintiff Bank on a condition to recover the debt first from the Principal Debtor, and then from the Surety. Then, the Bank (Plaintiff) went on appeal to Supreme Court to challenge the validity of the condition. The Supreme Court set aside the condition and held that the Plaintiff Bank could proceed first against the Surety (ignoring the principal debtor).

The Allahabad High Court has also taken the similar view in case of *Uttar Pradesh Financial Corporation v. Garlon Polyfeb Industries*, AIR 2001 All 286, although without reference to the Supreme Court ruling. The loans of a company were guaranteed. The guarantee stipulated that the liability of the surety would arise on demand. There was no condition that the financial corporation should first proceed to recover the amount from the hypothecated property. The corporation could straightaway proceed against the surety without first proceeding against the company. The order directing the corporation to first proceed against the company was held to be not proper.

In a subsequent case, *Union of India v. Manku Narayana*, (1987) 2 SCC 335: AIR 1987 SC 1078, the Supreme Court held that the creditor must proceed against the mortgaged property first and then only against the surety for the balance, even if the decree is a composite one against the principal debtor, mortgaged property and the guarantor. In that case only a portion of the decree was covered by the mortgage and the court did not consider it relevant whether the two portions of the decree were severable or not. This decision has been overruled by the Supreme Court in State Bank of India v. Indexport Registered. In this case a composite decree was passed against the surety, the borrower and the mortgaged property of the borrower.

Ram Bahadur Singh v. Tehsildar Bisli, A.I.R. 2002 All. 344 :

In this case, the decision of the Supreme Court in *State Bank of India v. Indexport Registered*, A.I.R. 1992 S.C. 1740 was followed and it was held that the guarantors cannot insist that creditor must first proceed against the principal borrower and not the guarantor. In other words, it is open to the creditor to proceed for making recovery against the guarantors without first proceeding against the principal borrower.

State Bank of India v. Gautami Devi Gupta, A.I.R. 2002 M.P. 81 :

In this case, it has been held that if there is a decree in favour of the creditor bank in his favour certain goods have been hypothecated, it is not necessary that the decree holder bank should proceed to recover the decretal amount first from the hypothecated goods and then proceed against the surety. Even without proceeding against the hypothecated property, the bank can proceed against the surety.

Union Bank of India v. Manku Narayan, A.I.R. 1987 S.C. 1078 :

In this case, it has been held by the Supreme Court that when there is a decree against the principal debtor, the guarantor and also against the mortgaged property, the decree-holder bank should first proceed against the mortgaged property and then against the guarantor.

In a contract of guarantee, the liability of the parties viz. Principal Debtor and Surety is joint and several. Now the question is, whether the creditor can sue the principal debtor or the surety alone ?

Action against Principal Debtor alone

The creditor can proceed against the principal debtor alone. His suit cannot be rejected on the ground that he has not joined the guarantor as a defendant to the suit(*Union Bank of India v. Noor Dairy Farms, (1997) 3 Bom CR 126*). Dismissal of the suit against the principal debtor does not of itself absolve the surety of his liability under the contract of guarantee (*Karnataka State Industrial Investment and Development Corporation Ltd. v. State Bank of India, (2004) 4 Kar LJ 266 (DB).*

A surety was allowed to be impleaded where his liability had already been reduced and his position would have been prejudiced if in the proceedings against the principal debtor this fact was not brought to the notice of the deciding authority (*B.R Thadani v. Oriental Bank of Commerce, (2002) 2 Bom CR 263 (Bom).*

Suit against Surety alone

A suit against the surety without even impleading the principal debtor has been held to be maintainable. In this case, the creditor, in his affidavit, had shown sufficient reasons for not proceeding against the principal debtor (*Pradip D Kothari v. Ceat Financial Services Ltd*, 2000 AIHC 4247 (Mad). A contract of guarantee was made enforceable by its terms against the guarantors severally

and jointly with that of the principal debtor company. It was held that the creditor had the option to sue the company alongwith guarantors as co-defendants or guarantors alone (*Vijay Singh Padole v. Sicom Ltd*, (2000) 4 MH LJ 772).

Sunder Singh vs. Punjab National Bank AIR 1992 All 132:

In this case, the plaintiff bank sued the defendant, Sunder Singh without taking any action against the principal debtor or the property hypothecated for repayment of the loan. The Supreme Court through Venkataramaiah J., justified the action of the plaintiff bank and held the defendant (surety) liable.

Guarantee on contract that creditor shall not act on it until co-surety joins (Sec. 144) : Section 144 speaks about the 'condition precedent'. Where there is a condition precedent to the surety's liability, he will not be liable unless that condition is first fulfilled. A partial recognition of this principle is to be found in Section 144 which runs as follows -

"Where a person gives a guarantee upon a contract that creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join."

National Provincial Bank of England v. Brackenbury, (1906) 22 TLR 797 : In this case, the defendant signed a guarantee which on the face of it was intended to be a joint and several guarantee of three other persons with him. One of them did not sign. There being no agreement between the bank and the co-guarantors to dispense with his signature, the defendant was held not liable.

Surety's liability in respect of void and voidable Contracts:—

The liability of Surety arises, when the Creditor proceeds against him. The contract between Surety and Creditor is independent, not collateral. It cannot always be said that Surety is

liable if the Principal Debtor is liable. Sometimes Surety may be liable, even though Principal Debtor is not liable.

Example : Suppose the Principal Debtor is a minor. Then the contract with Minor is void. A minor can be a promisee (beneficiary), but cannot be a promisor. In such a case, Surety is liable as a principal debtor.

Kashiba v. Sripal Narshiv, ILR(1894) 19 Bom 697 : In this case, Farran, J., observed -

"There is nothing unlawful, immoral or even improper in lending money to the minor, and we can see no reason in the absence of enactment to the contrary, why a person cannot contract to guarantee the performance by a third person of the duty of imperfect obligation. The case is perhaps still more clear if the promise of the infant to repay the money is void. In that case the contract of the so-called surety is not a collateral but a principal contract."

***Courts v. Brownee Lacky*, (1947) 1 KB 104 :** In this case, Kings Bench of England held that where a person guarantees, the payment of a loan by way of overdraft to an infant, he is liable if the fact of infancy is known to both the parties. The decision in this case has been subjected to criticisms on the ground that it will allow guarantor to escape liability and is necessary for the protection of minors.

Kelappan Nambiar v. Kunhi Raman, AIR 1957 Mad 164: In this case, the Madras High Court held that a surety incurs no liability by guaranteeing a debt by a minor for his liability is co-extensive with that of the principal debtor. While delivering the judgement, Rajgopala Ayyangar, J., observed -

"In the absence of special circumstances, like fraudulent representation or in the absence of other features from which a court could infer the contract to be one of indemnity, as defined in Section 124 of the Indian Contract Act, the liability of the surety is

only ancillary and can rest only on the valid obligation on the part of the party whose debt or obligation is guaranteed."

The learned Judge also pointed that Kashiba's case if understood in the light of the above observation, is not against the view for obligation undertaken by father seems to be one of indemnity rather than of guarantee. Thus unless it is clear that the contract is of indemnity, the liability of surety is ancillary and rests on a valid obligation on the part of the party whose debt or obligation is guaranteed.

Thus the surety will be liable in respect of a void debt provided that it is a contract of indemnity but will not be liable if it is a contract of guarantee. It may be submitted that the view of Rajagopala Ayyangar, J., appears to be correct but in the absence of a clear observation by the highest tribunal the position is likely to remain fluid.

Surety's liability in respect of Continuing Guarantee:

Section 129 of the Indian Contract Act, 1872 deals with continuing guarantee. It runs as follows -

"A guarantee, which extends to series of transactions is called a 'Continuing Guarantee'.

Illustrations :

(a) A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of Rs. 5,000, for the due collection and payment by C of those rents. This is a continuing guarantee.

(b) A guarantees payment to B, a tea-dealer, to the amount of 100 pounds, for any tea he may from time to time supply to C. B supplies C with tea to above the value of 100 pounds, and C pays B for it. Afterwards, B supplies C with tea to the value of 200 pounds. C fails to pay.

The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of 100 pounds.

(c) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

Surety is liable for all such transactions during the continuance of the suretyship.

In view of the facts and circumstances stated above, it is said that "Surety is a favoured Debtor".

In the words of Lord Selborne ***"A surety is undoubtedly and not unjustly an object of some favour both at law and at equity".***

6. Co-Sureties

Sections 138, 144, 146 and 147 of the Indian Contract Act, 1872 lay down the provisions relating to liability of Co-sureties.

Section 138 - Co-surety: Meaning : Where there are two or more sureties in a Contract of Guarantee, they are called 'Co-Sureties'. The liability of Co-surety is joint and several. In other words, the Creditor can sue both debtor and all co-sureties or can sue all the sureties jointly or he can sue one or more co-sureties. If all co-sureties are jointly sued, they have to meet the liability proportionately. Eg. 'A' lends 'B' Rs. 30,000/- against guarantee by 'C', 'D' and 'E'. If 'A' sues all ('C' 'D' 'E'), they have to pay @ Rs. 10,000/- each.

In case only one Co-surety is sued, and he has met the entire liability, he can sue the other Co-sureties for contribution proportionately. In the absence of an agreement to the contrary, all

Co-sureties are equally liable. In case of any agreement, the degree of liability varies from one Co-surety to other. Eg. 'A' lends 'B' Rs. 30,000/- 'C' gives guarantee upto 50% (Rs. 15,000/-) while 'D' and 'E' guarantee 25% each. In this example, the extent of Co-surety's liability differs.

Release of one co-surety does not discharge other (Section 138) : Where there are co-sureties, a release by the creditor of one of them does not discharge the others, neither does it free the surety so released from his responsibility to the other sureties.

Guarantee on contract that creditor shall not act on it until co-surety joins (Section 144) : Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

Co-sureties liable to contribute equally (Section 146) : Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.

Illustrations :

(a) A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,000 rupees each.

(b) A, B and C are sureties to D for the sum of 1,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the

extent of one-half, E makes default in payment. As between the sureties, A is liable to pay 250 rupees, B 250 rupees, and C 500 rupees.

Liability of co-sureties bound in different sums (Section 147) : Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Illustrations :

(a) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are each liable to pay 10,000 rupees.

(b) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

(c) A, B and C, as sureties for D, enter into three several bonds each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

State Bank of India v. G.J.Herman, A.I.R. 1998 Ker. 161 : In this case, it has been held that when there is a composite decree against the principal debtor and the sureties, the creditor has the discretion to decide against whom he wants to proceed. Neither the court nor a co-surety can insist that the creditor should first proceed against another surety before proceeding against him. Such

a direction would go against the co-extensiveness of the liability of the sureties with that of the principal debtor.

7. Continuing Guarantee

Sections 129 to 131 of the Indian Contract Act, 1872 lay down the provisions relating to "Continuing Guarantee'.

Continuing Guarantee : Meaning : Where a guarantee extends to a series of transactions, it is called 'Continuing Guarantee'. In this case, surety's liability extends to all the transactions comtemplated until the guarantee is revoked. In continuing guarantee, the liability extends to series of transactions.

Section 129, which deals with 'continuing guarantee' runs as follows -

"A guarantee which extends to a series of transactions, is called a 'continuing guarantee'.

Illustrations :

(a) A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of 5,000 rupees, for the due collection and payment by C of those rents. This is a continuing guarantee.

(b) A guarantees payment to B, a tea-dealer, to the amount of 100 pounds, for any tea he may from time to time supply to C. B supplies C with tea to above the value of 100 pounds, and C pays B for it. Afterwards, B supplies C with tea to the value of 200 pounds. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of 100 pounds.

(c) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a

month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

Revocation of Continuing Guarantee (Sec. 130): Sec. 130 deals with "revocation of continuing guarantee" It reads as follows -

"A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

Illustrations :

(a) A, in consideration of B's discounting, at, A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 rupees. B discounts bills for C to the extent of 2,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2,000 rupees, on default of C.

(b) A guarantees to B, to the extent of 10,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C, C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

A continuing Guarantee may be revoked by the Surety in the following ways:

i) By Notice;

ii) By Death of the Surety (sec. 131) and

iii) Any other mode.

i) By Notice : The Continuing Guarantee may be revoked by

the surety at any time as to future transactions by giving notice to the Creditor.

ii) By Death of the Surety (Sec. 131) : Section 131 of the Indian Contract Act, 1872 deals with "Revocation of Continuing Guarantee by surety's death". It reads as follows -

"The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions."

Continuing guarantee stands revoked on the death of the Surety. The liability does not extend to the legal heirs/representatives unless there is an agreement to that effect.

iii) By other mode: Continuing Guarantee is revoked by all such modes, when surety is discharged from the liability.

8. Discharge of Surety's Liability

Sections 130 to 139 of the Indian Contract Act, 1872 lay down the provisions relating to "discharge of surety". Discharge of surety means termination of Surety's liability. Surety is said to be discharged, when his liability comes to an end. Following are the different modes, by which surety is discharged from the liability.

1. Revocation of Liability (Section 130);
2. By Death (Section 131);
3. By Novation (Secton 62);
4. By Variance in the terms of the contract (Sec. 133);
5. Discharge or Release of Principal Debtor (Sec.134);
6. When creditor compounds with, gives time to, or agrees not to sue, the principal debtor (Section 135);
7. By creditor's act or omission impairing surety's eventual remedy (Section 139);

8. By loss of the security by the creditor (Section 141); and

9. By Invalidation of Contract (Section 142).

1. By Revocation (Sec.130) :— In Continuing Guarantee, the surety can revoke his liability as to the future transaction by giving a notice to the Creditor. But, he cannot revoke in respect of a specific guarantee or in respect of the transaction already entered into. Eg. 'A' executed a guarantee to 'B' to give a loan of Rs. 10,000/- to 'C'. 'A' can revoke the guarantee to be discharged from the liability before the loan is given by 'B'. If the loan has already been received by 'C', 'A' cannot revoke the guarantee.

Section 130, which deals with "revocation of continuing guarantee" reads as follows -

"A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor."

Illustrations :

(a) A, in consideration of B's discounting, at, A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 rupees. B discounts bills for C to the extent of 2,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2,000 rupees, on default of C.

(b) A guarantees to B, to the extent of 10,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C, C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

2. By Death (Section 131) : Section 131 speaks about the revocation of continuing guarantee by surety's death. It runs as follows -

The death of surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

In other words, death of surety extinguishes the liability and does not extend to the legal representatives unless there is an agreement to that effect.

3. By Novation (Section 62) :— Novation means substitution of a new contract of guarantee in the place of an old/existing contract of guarantee. The novation may be between the same parties or different parties under same terms or different terms and conditions. The surety is liable under the terms of the old contract. When, the old contract, by novation gets discharged, the surety also gets discharged from the liability.

Section 62 speaks about the effect of novation, rescission, and alteration of contract. It reads as follows -

"If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed."

Illustrations :

(a) A owes B 1,000 rupees. A enters into an agreement with B, and gives B a mortgage of his (A's) estate for 5,000 rupees in place of the debt of 10,000 rupees. This is a new contract and extinguishes the old.

(b) A owes money to B under a contract. It is agreed between A, B and C, that B shall thenceforth accept C as his debtor, instead of A. The old debt of A to B is at an end, and a new debt from C to B has been contracted.

(c) A owes B 1,000 rupees under a contract, B owes C 1,000 rupees, B orders A to credit C with 1,000 rupees in his books, but C does not assent to the agreement. B still owes C 1,000 rupees, and no new contract has been entered into.

4. By Variance in the terms of the Contract (Sec.133): Section 133 provides for "discharge of surety by variance in terms of contract". It runs as follows -

"Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance."

Illustrations :

(a) A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to over-draw, and the bank loses a sum of money.

A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

(b) A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.

(c) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.

(d) A gives to C a continuing guarantee to the extent of 3,000 rupees for any oil supplied by C to B on credit. Afterwards, B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then, existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement.

(e) C contracts to lend B 5,000 rupees on the 1st March. A guarantees repayment. C pays Rs. 5,000 rupees to B on the 1st January, A is discharged from his liability, as the contract has been varied, in as much as C might sue B for the money before the first of March.

When the surety gives guarantee (undertakes the liability) on certain terms, the terms shall remain unchanged during (throughout) the period of guarantee. If there is any variance (change) in the terms of the contract between the principal debtor and creditor, without the consent of the surety, the surety gets discharged as regards transactions subsequent to such. In other words, the surety is not liable for the altered contract. The plea that the alteration is not prejudicial or it is beneficial to the surety is not a ground for denying the discharge.

Pratap Singh vs. Kesavalal : 'X' agreed to give a loan to 'Y' on the security of four properties. 'A' gave guarantee. Actually, 'X' gave a loan of smaller amount on the security of three properties. As there was a change in the terms of the original contract, the guarantor was discharged from the contract/liability.

Bonar v. Macdonald, (1850) 3 H.L.C. 226 **:** In this case, the defendant was surety for the conduct of a bank manager. Subsequent to this agreement, the bank enhanced manager's salary and the manager agreed to be liable for 1/4 of the losses on discounts allowed by him. This arrangement between the bank and its manager

had been made without the knowledge of the surety. It was held that this arrangement had resulted in the discharge of surety.

5. Release or Discharge of Principal Debtor (Section 134): Section 134 provides for "Discharge of surety by release or discharge of principal debtor". It runs as follows -

The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustrations :

(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(b) A contracts with B to grow a crop of indigo on A's land and to deliver to B at a fixed rate, and C guarantees A's performance of this contract. B diverts a stream of water which is necessary for irrigation of A's land, and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

(c) A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber, C is discharged from his suretyship.

When the principal Debtor is discharged from the liability, it also discharges surety from the liability. When the principal debtor clears the debt in full and is discharged from the liability it also

discharges the surety from the liability. Any act or omission on the part of the creditor, may discharge the surety from the liability. Eg. 'A' against the guarantee by 'B' agreed to supply construction material to 'C' to build a house. Omission or failure to supply the construction material by 'A', discharges 'B' from the liability.

6. When creditor compounds with, gives time to, or agrees not to sue the principal debtor (Sec. 135) : Section 135 mentions further circumstances when a contract between the creditor and the principal debtor can result in the discharge of the surety. It runs as follows -

"A contract between the creditor and the principal debtor by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract."

According to this section, a contract between the creditor and the principal debtor discharges the surety in the following three circumstances -

(i) When the creditor makes composition with the principal debtor,

(ii) When the creditor promises to give time to the principal debtor, and

(iii) When the creditor promises not to sue the principal debtor.

It may be noted that in the above stated circumstances, the surety is discharged if the creditor and the principal debtor make such contract without the consent of the surety. It such a contract is made with the consent of the surety, he would not be discharged.

Kurian v. The Alleppey C.C.M.S. Society, A.I.R. 1975 Kerala 44 : In this case the creditor filed a suit against the debtor for the recovery of some money due from the debtor. Then there was a compromise between the two parties to the suit according to which the debtor was allowed to pay the decretal money within

nine months from the date of compromise. This happened without the knowledge or consent of the surety. If was held that this arrangement meant giving time to the debtor within the meaning of section 135, and the surety was, therefore, discharged from his liability.

7. Discharge of surety by creditor's act or omission impairing surety's eventual remedy (Sec. 139) : Section 139 of the Indian Contract Act, 1872 runs as follows -

"If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged."

Illustrations :

(a) B, contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment.

(b) C lends money to B on the security of a joint and several promissory note made in C's favour by B, and by A as surety for B, together with a bill of sale of B's furniture which gives power to C to sell the furniture, and apply the proceeds in discharge of the note. Subsequently, C sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realised. A is discharged from liability on the note.

(c) A puts M as apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will at least once a month, see M make up the cash. B omits

to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

M.R.Chakrapani v. Canara Bank, A.I.R. 1997 Guj. 48 : In this case, the property hypothecated to the bank was sold by the principal debtor. The surety immediately furnished particulars of the sale to the bank, but the bank took no steps either to trace and seize the property or failed to take any action against the principal debtor by lodging a complaint with the police or filing a case in a criminal court for tracing and attachment of property and recovering the dues. It was held that the surety was discharged due to inaction of the bank.

8. By loss of the security by the creditor (Sec. 141) : Section 141 deals with surety's rights to the benefit of creditor's securities. It runs as follows -

"A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and if the creditor loses, or without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security."

Illustrations :

(a) C, advances to B, his tenant 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B's furniture. C, cancels the mortgage. B becomes insolvent and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

(c) A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

9. By Invalidation of the Contract (Section 142): According to Sec. 142, guarantee obtained by misrepresentation is invalid. It reads as under -

"Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid."

When the contract is declared invalid subsequently, the surety is discharged from the liability.

Example: When a Surety is consented to, by employing a flaw in consent (mis-representation etc.) and such contract is voidable, the surety is discharged from the liability.

9. Surety's Rights

Sections 140 to 147 of the Indian Contract Act confer on Surety certain rights, which may be explained under the following heads:

1. Rights of Surety as against the Creditor;
2. Rights of Surety as against Principal Debtor; and
3. Rights of Surety as against Co-sureties

1. Rights of Surety as against the Creditors:

i) Right to securities with the creditor (Sec.141) : Section 141 provides for surety's right to the benefit of creditor's securities. It runs as follows -

"A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the

existence of such security or not; and if the creditor loses, or without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security."

Illustrations :

(a) C, advances to B, his tenant 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B's furniture. C, cancels the mortgage. B becomes insolvent and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

(c) A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

State of M.P. v. Kaluram, A.I.R. 1967 S.C. 1105 : In this case, the surety was discharged by the loss of security by the creditor. The facts of the case are as follows. The respondent, Kaluram, was a surety for the payment of felled trees which were sold by the appellant to one Jagat Ram. The buyer of the trees was to make the payment in four instalments. He paid only one instalment and then defaulted. The appellant had a right under the contract to prevent the purchaser from removing the trees when he was in default. The appellant failed to do so. The court held that the appellant, by allowing the buyer to take away the trees, had allowed the security to be lost, and the surety was, therefore, discharged to that extent.

According to Section 141, surety has a right to demand from the creditor, all the securities, which the creditor had, if he paid the debt in full against the default of the principal debtor. The surety cannot exercise the right over the securities for making part payment as laid down in the case of *Goverdhandas vs. Bank of Bengal.*

ii) Right to request :— Surety has a right to request the creditor to elect/choose the principal debtor to sue before he (surety) is called upon to pay the debt.

2. Rights against the Principal Debtor:

i) Right of Subrogation (Sec.140) :— Section 140 confers on Surety, the right of subrogation. The term 'Subrogation' literally means "transfer of right (to sue) from one person to another". In a contract of guarantee the right of charge over the securities is vested in the creditor. According to Sec. 140, where the surety has cleared/paid the debt in full against the default by the principal debtor, all the rights, which the creditor has against the principal debtor get transferred to the surety. In other words, the surety enters into the shoes of the creditor and can sue the principal debtor for recovery of the payment made by him (i.e. by surety).

Section 140, which confers on surety, the right of subrogation runs as follows -

"Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor."

ii) Right of Indemnity (Sec.145) :— In a contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety, from losses caused to him as a result of the contract. In other words, the surety can recover from the principal debtor whatever sum he might have rightfully paid under the guarantee.

Surety's right of indemnity is enshrined in section 145 of the Indian Contract Act, 1872, which runs as follows :

"In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he had rightfully paid under the guarantee, but no sums which he has paid wrongfully."

Illustrations :

(a) B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit having reasonable grounds for doing so, but he is compelled to pay the amount of debt with costs.

He can recover from B the amount paid by him for costs, as well as the principal debt.

(b) C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands paymentof it from A, and, on A's refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

(c) A guarantees to C, to the extent of 2,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,000 rupees, but obtains from A payment of the sum of 2,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

C.K. Aboobacker v. K.P. Ayishu, A.I.R. 2000 NOC 29 (Kerala) : In this case, it has been held by the Kerala High Court

that a guarantor is liable for any payment or performance or any obligation only to the extent the principal debtor has defaulted. If a substantial portion of the loan has been paid by the principal debtor, the guarantor is to pay only the balance due. According to section 145, after the surety has paid the amount, the principal debtor should indemnify the surety for everything the surety has rightfully paid under the contract of guarantee.

iii) Right to be relieved :— Surety has a right to compel the principal debtor to relieve him from the liability by paying off the debt.

3. Rights of Surety against Co-sureties (Sec. 146):

In a contract of guarantee, if there are two or more sureties, they are called "Co-sureties". The liability of the Co-sureties is joint and several. The creditor may sue one or all. If only one surety is sued and he alone has paid the debt, he may ask/demand the Co-sureties to contribute proportionately. Such right of the Surety to demand contribution from the Co-sureties is called "the right of contribution".

Section 146 of the Indian Contract Act, 1872 confers on 'surety' the right of contribution. In other words, section 146 says that the co-sureties are liable equally. It runs as follows -

"Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor."

Illustrations :

(a) A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and

C are liable, as between themselves, to pay 1,000 rupees each.

(b) A, B and C are sureties to D for the sum of 1,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 250 rupees, B 250 rupees, and C 500 rupees.

The duty of the co-sureties is to contribute equally. This is so when they are co-sureties for the same debt. It is immaterial that they have undertaken a duty either jointly or severally, or under the same or different contracts, or with or without the knowledge of each other.

Case Comment : Part - C

In Andhra Pradesh, the question paper of Contracts-II comprises of three parts viz. Part-A, Part-B and Part-C. Part-A contains short questions; Part-B contains essay questions. In Part-C, the questions are asked in the form of problem (as in the case of A.U., S.V.U.) or in the form of a case itself (as in the case of N.U.) If the question is asked in the form of a case, the student has to write about that case in detail as follows:

Q. Discuss the facts and law laid down in the case of:

Gajanan Moreswar vs. Moreswar Madan (N.U., April '99, Part-C Q.No. 15)

Ans. This case relates to Sec.125 of the Indian Contract Act, 1872 which deals with the right of the indemnity holder under the contract of indemnity.

The rights of indemnity holder have been well-explained in this case and it has attained great importance.

Gajanan Moreswar vs. Moreswar Madan, **AIR 1942 Bom. 302:**

Facts of the Case : Gajanan, the plaintiff in the instant case, was a lease-holder of a plot of land under the Bombay Municipality for a long period. He transferred the lease to the defendant, Moreswar Madan and the same was approved by the Municipality. But no execution to that effect was made in favour of the defendant. So, the lease continued to remain in the name of the plaintiff. The defendant borrowed Rs. 5,000/- from 'A'. The lease-hold interest was given as security to 'A'. The plaintiff at the defendant's request, executed the mortgage. The defendant agreed to pay the principal and interest and release the mortgage. As the defendant did not pay and release the mortgage deed, the plaintiff sued the defendant for indemnity. The defendant contended that the suit was premature as the plaintiff had not yet suffered any loss. But the court did not consider/allow the above contention and held the defendant liable.

Issues/Questions :— The Issues/Questions involved in the instant case are:

1. The question is, whether the plaintiff can sue on the indemnity before he has suffered any loss or whether Sections 124 and 125 of the I.C. Act, would apply or not, where the indemnity-holder has not suffered any loss or damage as a consequence of the defendant's failure to pay and release the mortgage deed?

2. Whether the plaintiff, the indemnity holder, (Gajanan) is entitled to recover the damages and other incidental charges?

Judgment/Decision:— The Privy Council, through Chagla J., answering the above questions in the affirmative decided in favour of the plaintiff and held the defendant liable.

Principle Applied :— Chagla J., observed, "If the indemnified (indemnity-holder) had incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to save him from the liability and pay it off."

(P.S. If question is asked in the form of a problem basing on the facts of the above case, the student has to write in brief about the meaning and definition of the Contract of Indemnity, rights of indemnity holder U/s. 125 in brief and then write in detail about the case as above.)

Q. Problem:— 'A' agreed with 'B' for supply of 2000 tons of iron. 'C' gave the guarantee to 'A' for the payment of price by 'B'. Subsequently, without the knowledge of 'C', 'A' and 'B' had privately agreed that 'B' should pay Rs.5/- per ton above the market price, which would be applied for discharge of an old debt. Examine the liability of 'C'. (A.U. Model Question Paper, Part-C, Q.No.2).

Ans:— Instant problem attracts Sec.133 of the Indian Contract Act, 1872, which speaks about (deals with) the discharge of a surety from the liability in the event of the variance (change) in the terms of the contract of guarantee.

The relevant case laws on this problem are :

1. Khatun Bibi vs. Abdullah (1880) 3 All. 3.

2. Bonar vs. Macdonald (1850) 3 H.L.C. 226.

Questions Involved :— The questions involved in the instant problem are:

1. In a contract of guarantee, whether the terms of the contract between the principal debtor and surety can be altered/changed without the knowledge of the surety?

2. Whether such alteration/variance in terms of the contract is binding on the surety or discharges him from the liability.

With regard to the first question, when the surety undertakes liability on certain terms in a contract of guarantee, the terms of the contract must remain unchanged during the whole period of the contract of guarantee and nothing can be changed in the terms of the contract without the notice/knowledge of the surety.

With regard to the second question, the surety agreed to be liable against the terms of the contract at the time of giving the guarantee. He cannot be held liable on the altered contract, which is different from the original contract. The altered contract is not binding on the surety and hence, he (surety) is discharged from the liability.

According to Sec.133 of the Indian Contract Act, 1872, 'C' the surety in the instant case is not liable as he gets discharged from the contract. The provisions of Sec.133 with relevant case are detailed below.

Section 133:— Sec.133 provides for one of the instances, under which, a surety is discharged from the liability. It says that, **"any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance."**

In other words, the surety is liable only when the terms of the contract remain unchanged throughout the period of the contract of guarantee. Variance (changes/alterations) subsequently, if any in the terms of the contract between the principal debtor and the creditor without the knowledge of the surety renders the contract discharged and hence, discharges the surety from the liability.

Relevant Case Law:

1. ***Kathun Bibi vs. Abdullah*** (1880) 3 All 3 :— 'A' guaranteed the payment of rent by 'B' under a lease granted by 'C'. Subsequently, 'C' enhanced the rent. It was held that 'A' was discharged from his suretyship in respect of the arrears of rent that accrued subsequent to such variance.

2. ***Bonar vs. Macdonald*** (1850) 3 H.L.C. 266:— In this case, the defendant was surety for the conduct of a bank manager. Subsequent to this agreement, the bank enhanced manager's salary and the manager agreed to be liable for 1/4 of the losses on discounts

allowed by him. This arrangement (variance in terms of contract) between the bank (creditor) and its manager (principal debtor) had been made without the knowledge of the surety. It was held that this arrangement had resulted in the discharge of surety.

In view of the above 'C' is not liable since variance in terms of the contract without his knowledge discharges him from the liability.

Questions and How to Answer

Different examiners ask/put the same question in different ways/styles. Then the student should not get himself confused and should try to understand the question clearly and then, he has to answer effectively in response to the questions.

For instance, the same question from 'the Liability of Surety' may be asked in different ways as follows:

(Q) What is the extent of Surety's Liability? (A.U., Sept./ Oct.1999, Part-B, Q.No.2).

Ans: It is a direct question. Write meaning and definition of the Contract of Guarantee and then, the Liability of Surety in detail.

(Q) Surety is a favoured Debtor - Discuss.

And: Instant (given) statement 'Surety is a favoured Debtor' is absolutely correct. The reason is : surety's liability is not only secondary but also primary and independent in certain cases. The creditor can directly proceed against the Surety, leaving/ignoring the Principal Debtor.

This question refers to 'Extent of Surety's Liability'. (Write now about surety and extent of his liability).

(Q) A surety is undoubtedly and not unjustly an object of some favour both at law and equity' - Explain this statement.

Ans: Lord Selborne made the above statement, "A surety is undoubtedly and not unjustly an object of some favour both at law and equity". It refers to Liability of Surety in a Contract of Guarantee, as detailed below: (Write now about Surety and extent of his liability).

(Q) Define Contracts of Indemnity and Guarantee and distinguish between the two (A.U., Model Question Paper, Part-A, Q.No.1).

Ans: It is a direct question. Write meaning and definitions of Indemnity and Guarantee and differences between the two.

(Q) What is meant by continuing guarantee. (A.U. Model Question Paper, Part-A, Q.No.2 & N.U., August, 1999, Part-A, Q.No.2)

Ans. Write the meaning of guarantee and then write about continuing guarantee in brief.

(Q) When is surety discharged from his liability (N.U., April 1999, Part-B, Q.No.11).

Ans: Write meaning and definition of the Continuing Guarantee and then, the discharge of surety in detail.

P.S. If the Student may not be able to answer in response to the questions as above, he may write simply about the topic on which the question has been asked.

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Lecture - III

BAILMENT AND PLEDGE

Chapter IX containing sections 148 to 181 of the Indian Contract Act, 1872 lays down the provisions relating to the Contracts of Bailment and Pledge. This Lecture covers:

1. Bailment: Meaning and Definition.
2. Essential Elements
3. Bailment and Sale
4. Bailment and Agency
5. Kinds of Bailment
6. Duties of Bailor
7. Rights of Bailor
8. Duties of Bailee
9. Rights of Bailee
10. Bailee's Lien
11. Finder of lost goods
12. Pledge : Meaning, Definition & Essentials.
13. Bailment and Pledge
14. Pledge and Hypothecation
15. Rights and Duties of Pawnee and Pawnor; and
16. Pledge by Non Owners

1. Bailment : Meaning and Definition

Meaning :— The term Bailment is derived from the French Word 'Bailor', which means 'to deliver'. It means change of possession voluntarily from one person to another. Eg. 'A' delivers

a cloth to 'B', a tailor for making a shirt. The contract between 'A' & 'B' is bailment. 'A' is a Bailor, and 'B' is a Bailee. Similarly, Radio & T.V. repairers; Motor Vehicles' Mechanics; Tailors and Launderers.

2. Essential Elements

To constitute Bailment, the following conditions are to be satisfied.

1. Delivery of goods for a specific purpose.
2. Contract
3. Return or disposal of goods.

1. Delivery of goods :— To constitute bailment, there must be a delivery of goods from one person to another for some specific purpose. Delivery means transfer of possession of the goods from one person to another. The delivery of goods to the bailee may be made by doing anything, which has the effect of putting the goods in the possession of the intended bailee or his authorised agent. Delivery need not always be actual. It may sometimes be a constructive or symbolic delivery. Section 149 of the Indian Contract Act, 1872 recognises other than actual delivery also. It provides :

"The delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf."

Transferring of the key of the godown may be deemed to be delivery of the goods. Explanation to section 148 gives an illustration of constructive theory. According to this provision : " If a person already in possession of the goods of another contracts to hold them as a bailee, he thereby becomes the bailee, and the owner becomes the bailor of such goods although they may not have been delivered by way of bailment." For example, A sells his watch to B. Instead of delivering the watch to B, A is asked to continue to

keep the watch with him for one month on B's behalf. After this arrangement, A is the bailee of the watch. The watch was already in the possession of A. Earlier he was having it himself as the owner, but now he holds the same as a bailee for B. A finder of goods is also deemed to be the bailee of those goods.

Jagdish Chandra Trikha v. Punjab National Bank, A.I.R. 1998 Delhi 266 :

In this case, the plaintiff's father had entrusted a box containing 480 tolas, i.e. about 5600 grams gold ornaments and jewellery to the defendant Bank at Peshawar (now in Pakistan) before the partition of the country. The jewellery box was locked, wrapped and sealed when delivered. A proper receipt describing the contents of the box was given by the Bank. From Peshawar the box came to Lahore Branch of the Bank and thereafter to the Delhi Branch. It was found that when the jewellery box was delivered to the plaintiff in Delhi, it was not in the same condition as it was delivered at Peshawar. The Lahore branch of the bank had put their own wrapper on the box and it was not locked.

The plaintiff claimed the gold ornaments and jewellery deposited with the bank or their value amounting to Rs. 3,72,400=00. It was held that the position of the bank was that of a bailee and it failed in its duty to take due care of the goods and return them to the plaintiff. The Bank was held liable to pay the sum of Rs. 3,72,400=00 alongwith simple interest @ 12 % p.a. from the date of the institution of the suit till the date of realisation of the amount.

Kaliaperumal v. Visalakshmi Achi, A.I.R. 1938 Mad 42: In this case, a lady engaged a goldsmith for melting old jewellery to make some new ornaments. She delivered the old jewellery to the goldsmith but every evening after the day's work was over, she used to take the half-made jewellery from the goldsmith and after putting them into a box with a lock left it in the room of the goldsmith while retaining the key with her. One morning she found that the jewellery had been stolen. She sued the goldsmith for the

loss of jewellery. It was held that the goldsmith was not liable for the loss because each evening there was re-delivery of the jewellery to the lady and consequently when they were stolen, they were not in possession of the goldsmith. The Madras High Court held that delivery is an essential element of bailment and mere leaving the box in the room of goldsmith while she retained the key, did not constitute delivery within the meaning of Section 149 of the Indian Contract Act, 1872.

2. Contract :— There can be no bailment without a contract. Bailment is a contract and hence, the essentials of contract under Section 10 of the Indian Contract Act viz., competence of parties, free consent, lawful object etc. are to be satisfied.

Ram Gulam vs. Govt. of U.P., AIR 1950 All 106 : In this case, the Allahabad High Court expressed the view that obligation of a bailee can arise only out of a contract of bailment and not otherwise. In this case, the plaintiff's property had been stolen. The same was recovered by the police and was kept in the police Malkhana. From there, it was again stolen and could not be traced. The plaintiff brought an action to recover the value of the property. The State was held not liable, firstly, because it did not occupy the position of a bailee and, therefore, it was not liable as such, and secondly, the police, when it took and kept the property in its possession, was acting in discharge of obligations imposed by law, rather than in obedience to some executive orders.

The point of discussion in the above case that a bailment cannot arise without a contract, does not appear to be convincing. The law itself recognises the finder of goods as bailee. In some subsequent cases, it has been held that bailment can be there even without a contract.

It has been rightly observed that many bailments arise out of contract, but the better opinion is that it is possible for bailment to exist without contract. It may also be noted that the term 'contract'

in Section 148 does not mean that there should always be a formal and complete contract. It may also be implied from the circumstance.

Jubilee Mills Ltd. v. Governor-General of Indian in Council, A.I.R. 1953 Bom. 46 : In this case, the Railway administration had permitted the plaintiff to keep certain bale of cotton on the platform as no wagons were available. The bales of cotton were damaged by a spark emanating from a passing engine. The Railway administration was held liable for by allowing the plaintiff to keep the goods at platform, the Railway Administration assumed the responsibility of a bailee.

3. Return or disposal of goods :— In bailment, the goods are delivered for a specific purpose viz., safe custody, repair, carriage etc. After the purpose is accomplished, the goods may be returned to the Bailor in the same or altered condition, or may be disposed of as directed by the Bailor.

United Breweries Ltd. v. State of A.P., (1997) 3 S.C.C. 530 : 1997 A.I.R. S.C.W. 1414 : In this case, the appellants sold beer in bottles to the customers. The customers were required to pay cost of beer and to deposit a sum for bottle which was refundable. The customers were advised to collect empty bottles from the consumers and return them to the appellants and get back their deposit for the bottles. For this purpose the appellants issued circulars to its buyers. The circulars contained following main points:

(1) The refundable deposits were being collected on the bottles and the crates.

(2) The appellant advised its customers to collect forty paise per bottle from the customers as deposit.

(3) The customers were advised to collect the empty bottles from the consumers and return them to the appellant.

(4) The empty bottles and crates were to be taken back by the trucks of the appellant, the drivers of which were authorised to issue a receipt for the empty bottles against

which the appellant would issue credit notes. At the time of the next booking of the next consignment, the customers would get advantage of the credit notes.

The above arrangement suggested that there was a continuous process by which the appellant would sell beer to its customers in bottles and crates and collect the sale price of the beer and also deposits for the crates and bottles. The customers on their turn, would sell beer to the consumers and apart from the price of the beer would also receive forty paise per bottle as deposit to ensure returns of the bottles. The bottles would ultimately be taken back by the appellant for which the trucks would be sent and the credit notes would be given to the customers for the return of the empty bottles and crates. This scheme of recycling the bottles and crates would keep down the costs and ultimately would have the effect of reducing the price of beer and encouraging the customers to buy beer in larger quantities. It was also found that as a matter of fact that the rate at which the customers were required to make the deposit of the beer bottles was less than the cost of the beer bottles. From the foregoing facts the Supreme Court came to the conclusion that the intention of the brewer did not appear to have been to sell the beer bottles, on the contrary the brewer was trying to ensure that the bottles in which the beer was supplied to the consumers through its customers were brought back to it so that they could be used again. The Supreme Court therefore held that there was no sale of bottles but in clear terms it was a bailment.

M/s Kalyani Breweries Ltd. v. State of West Bengal, A.I.R. 1998 SC 70 : In this case, the appellants brewed and sold beer in bottles and the customers were required to deposit rate of beer of bottles which was exactly equal to the cost of the bottle. Money deposits on account of cost of bottle was to be refunded when empty bottles were returned by customers. In case the empty bottles were not returned, the deposits thereof were forfeited and was shown in an account called "Bottle Deposit Forfeited Account".

The Supreme Court held since the customers were required to deposit for the beer bottles a rate which was exactly equal to the cost of the bottles, this would suggest the sale thereof more strongly than the intention to get them back upon bailment. It appears from the facts and circumstances of the case that there was really a sale of the bottle to the customers, the assessee buying back the empty bottles from same customers that is why, the assessee could show a refund of Rs. 11,62,974/- out of total amount of deposits, namely Rs. 30,57,143/-. Had there been a bailment, which necessarily pre-supposes that the bailee was aware of the terms thereof, a larger refund would have been shown. In this appeal, the appellants relied upon, the case of United Breweries Ltd.(1997 AIR SCW 1414), but the Supreme Court observed that that case proceeded upon the very clear terms of the bailment that were made known by circulars to the customers. There the Apex Court found that the intention of the brewer was to get the empty bottles back, as evidenced by the fact that the rate of the deposit was less than the cost of the beer bottles.

Thus in the instant case, the Supreme Court held that there was really a sale of bottles and hence the amount of Rs. 16,55,355 shown as forfeited was legally made liable to sales tax.

3. Bailment and Sale

Sale literally means "transfer of absolute interest in property (movable goods or immovable) from one person to another in lawful consideration of price paid or promised.

Section 4(1) of the Sale of Goods Act, 1930 defines "Contract of Sale of Goods", as a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.

The person who sells or agrees to sell is called 'Seller' or 'Vendor'(Sec. 2(13). The person who buys or agrees to buy is called 'Buyer' or 'Purchaser' (Sec. 2(1). The contract between the Seller and Buyer is called 'the contract of Sale".

Following are the notable points of distinction between bailment and sale.

Bailment	Sale
1. The object of bailment is temporary possession of the goods in the hands of the bailee.	1. The object of sale is permanent transfer to the purchaser.
2. The ownership does not change. The bailor is the owner of the goods before, during and after the period of bailment	2. After sale transaction, the purchaser becomes owner. The seller does not possess any connection with the property sold.
3. The bailee cannot appropriate the property bailed to him.	3. The purchaser can appropriate the property purchased by him.
4. The bailor pays some nominal charges to the bailee for the services rendered by him. Some times, he is not required to pay any charges.	4. The transferee shall have to pay the full market value of the property to buy property.
5. On certain occassions, the bailee can exercise his right of lien over the goods bailed.	5. The seller of the property has no such right of lien. However, an unpaid seller of goods can exercise lien or stoppage in transit.

4. Bailment and Agency

Agency : Meaning and Definition : Sections 182 to 238 of the Indian Contract Act, 1872 lay down the provisions relating to the Contract of Agency.

Meaning : When a person appoints another to act on his behalf with a third party, it is called 'Agency'. The person who

appoints is called 'Principal'. The other person, who is appointed is called 'Agent'. The contract between them (i.e. Principal and Agent) is called 'Contract of Agency'.

Definition : 'Agency is the legal relationship between an agent and Principal; to bring the principal into legal relationship with the third party.'

Example : 'A' appoints 'B' to purchase some property on his behalf. Here, 'A' is principal and 'B' is Agent. The relationship between 'A' and 'B' is called Agency.

Definition of Agent and Principal (Sec. 182) : An 'Agent' is a person employed to do any act for another or to represent another in dealings with third person. The person for whom such act is done or who is so represented is called the 'Principal'.

Any person, who is a major and is of sound mind may appoint an agent (Sec. 184). Consideration is not necessary for creation of an agency (Sec. 185).

Following are the notable points of distinction between bailment and agency.

Bailment	Agency
1. The bailee does not represent the bailor. He does not derive any authority from the bailor.	**1.** The agent represents his principal, and derives certain power from his principal.
2. A bailee cannot sell the property under bailment.	**2.** An agent can sell the property.
3. A bailee has no such powers.	**3.** An agent can contract with others.
4. A bailee cannot transfer the ownership of the property.	**4.** An agent can transfer the ownership of the property.
5. A bailee must have possession of the property.	**5.** An agent may or may not have possession of the property.

5. Kinds of Bailment

Bailment may be classified under the following heads:

1. Bailment for the benefit of the Bailor.
2. Bailment for the benefit of the Bailee.
3. Bailment for the benefit of both the bailor and bailee.
4. Gratuitous Bailment.
5. Non-gratuitous Bailment.

1. Bailment for the benefit of the Bailor:— Where a bailor delivers his goods to a bailee normally for a safe custody without any reward, it is called "the bailment for the benefit of the bailor".

2. Bailment for the benefit of the Bailee:— If the bailor delivers/lends goods to a bailee without any hire for his use, it is called "the bailment for the benefit of the Bailee".

3. Bailment for the benefit of both the bailor and bailee:— If the goods are delivered for consideration, both the bailor and bailee derive benefit and hence, it is called "the bailment for the benefit of both the bailor and bailee".

4. Gratuitous Bailment:— A bailment made without any consideration for the benefit of the bailor or for the benefit of the bailee is called "Gratuitous Bailment".

5. Non-Gratuitous Bailment:— It is a bailment for reward. It is for the benefit of both the bailor and bailee.

Rights and Duties of Bailor and Bailee

Where a person has a right, there is a corresponding duty on another. Rights and duties are corresponding to each other and are correlative. Therefore, the rights of the Bailor are the Duties of the Bailee. Similarly, the duties of the Bailor are the rights of the Bailee.

6. Duties of Bailor

Section 150 classifies bailors into two categories for the purpose of their duties, namely -

(1) A gratuitous bailor

(2) A bailor for reward.

(1) Gratuitous Bailor : A gratuitous bailor is one who lends his goods without consideration. Since he receives no consideration, his duty is much less than that of a bailor for reward. He is bound to disclose to the bailee the fault in the goods bailed. But he is liable to disclose, the faults of which he is aware and which may materially interfere with the use of them, if the bailor does not make such disclosure he will be responsible for damage arising to the bailee directly from such faults. It is well settled that a gratuitous bailor is not liable for faults or defects in the goods lent of which he is not aware.

For example, A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

(2) Bailment for Reward : Second part of Section 150 of the Indian Contract Act, 1872, provides that -

"If the goods are bailed for hire the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed."

For example, A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

Hyman v. Nye & Sons, (1881) 6 Q.B.D. 685 : In this case, the plaintiff hired a carriage and horses from the defendant for a particular journey. The carriage being defective, it was upset

and the plaintiff was injured thereby. The defendant was held liable for injury to the plaintiff.

The duties of bailor may be explained with reference to the following heads namely -

i) To disclose known facts of the goods bailed (Sec. 150)

ii) To bear the extraordinary expenses (Sec.158)

iii) To indemnify the loss (Sec.159)

iv) To take back the goods (Sec.161).

i) To disclose known facts of the goods bailed (Sec.150):— Bailor has a duty to inform the Bailee, the faults and defects of the goods bailed. Otherwise, he is liable. Eg. 'A' lends his defective vehicle to 'B'. 'A' knows the defect, but does not disclose the same to 'B'. 'A' is liable for the loss suffered by 'B'.

Section reads as follows -

"The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If such goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

Relevant case on this point is : *Lyell vs. Ganga Dai*

In this case, the defendant (Bailor) delivered the goods of a dangerous character (explosives) to a carrier (Bailee). In an action by the plaintiff, the defendant was held liable (for non-disclosure).

ii) To bear extraordinary expenses (Sec. 158) :— The Bailor has a duty to meet the extraordinary expenses incurred by the Bailee. He is also responsible for the ordinary and reasonable expenses. Section 158 reads as follows -

"Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor and the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment."

iii) To indemnify the loss (Sec.159):— Indemnity means promise to make good the loss. Bailor has a duty to indemnify the loss suffered by the bailee under the contract. Section 159 runs as follows -

"The lender of a thing for use may at any time require its return, if the loan was gratuitous, even though he lent it for a specified time or purpose. But if, on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan, the lender must, if he compels the return, indemnify the borrower for the amount in which the loss so occasioned exceeds the benefit so derived."

iv) To take back the goods (Sec.161) :— In bailment, the goods are delivered for a specific purpose. After the purpose is served, the goods may be returned to the bailor. Then, he has a duty to take them back.

When the purpose of bailment is accomplished or the time for which the goods were bailed has expired, the bailee should return the goods to the bailor without demand. If he fails to do so, he will keep the goods at his risk and will be responsible for any loss of or damage to the goods arising howsoever.

Section 161 deals with the bailee's responsibility, when goods are not duly returned. It runs as follows -

"If by the fault of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time.

7. Rights of Bailor

The Rights of the bailor are stated hereunder.

i) Enforcement of Rights

ii) To avoid the contract

iii) Right to claim increase in profit.

iv) Right against third party (subrogation).

i) Enforcement of rights : The Bailor can sue the Bailee to enforce his rights or the duties and liabilities of the Bailee.

ii) To avoid the contract : The bailor has a right to avoid or terminate the contract, if bailee acts contrary to the terms of the contract.

iii) Right to claim increase in profit : If there is any increase in the profit of his goods with the Bailee, he can claim such extra profit.

iv) Rights against third party (Subrogation) : This point is discussed in 'Doctrine of Subrogation'. 'Subrogation' means "transfer of right (to sue) from the person to another person". If the third party causes loss to the goods in bailee's possession, bailor can sue that third party. In subrogation, the bailee's right to sue the third party gets transferred/ subrogated to the bailor. In other words, the bailor enters into the shoes of the bailee and acquires the right to sue the third party.

Rights and Duties of Bailee

'Bailee' is a person to whom goods are delivered under a contract of bailment. Following are the rights and duties of the Bailee.

8. Duties of Bailee

The duties of the bailee may be explained under the following heads:

i) To take care of the goods bailed (Sec.151)

ii) Not to make unauthorised use of the goods bailed (S.154)

iii) To act in conformity with terms and conditions of the Contract (Sec.153).

iv) Not to mix the goods bailed with his own goods (S.155) and

v) To return the goods bailed, after the purpose is accomplished (Sec.160).

i) To take care (Section 151) :— Section 151 of the Act imposed a duty on bailee, as a reasonable and prudent man, to take much care of the goods bailed. The burden of proof that he had taken a reasonable care and had not acted negligently lies on the bailee. Section 151 runs as follows -

"In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed."

Calcutta Credit Corporation v. Prince Peter, A.I.R. 1964 Cal. 374 :— It was held in this case that loss of bailee's goods along with bailor's goods is not an evidence that he had taken proper care.

Baldeo Narain vs. State of Bihar (1959) :— The plaintiff in the instant case was an agent of the State Government. His duty was to procure paddy and to store them in the godown. Due to heavy rain, the paddy was washed away. It was held that the plaintiff was entitled to indemnity, since the loss was due to act of God.

Union of India v. Udho Ram & Sons, A.I.R. 1963 S.C. 422 : In this case, certain goods were consigned by M/s Radha Ram Sohan Lal from Calcutta to Delhi by rail. and the Railway Receipt was endorsed in favour of the plaintiffs, M/s Udho Ram and Sons. Some of the articles out of this consignment, having been stolen during transit, the same were not delivered to the plaintiffs. The plaintiffs brought an action to recover compensation for the same. The trial court found that the wagon in which the goods were loaded was properly rivetted and sealed when the train left Howrah at 1.30 a.m. but seals and rivets of one of the doors of the wagon were found open when it reached Chandanpur station after about 2 hours. The theft took place at an in-between point when the train stopped there for the home signal at 2.05 a.m.for about 15 minutes. It was found that railway protection police was also there in the guard's van. The question which had arisen in this case was, could the railway authorities be considered to be negligent and guilty of failing to take due care as prescribed by section 151, Indian Contract Act ?

It was held that the railway did not take due care. Firstly, they did not prove from record that the railway protection police which escorted the train was sufficient in strength, and secondly, that unlike a prudent man, the railway protection police did not keep an eye on wagons, particularly when the train stopped, to prevent the theft of the goods. The defendants were held liable.

ii) Unauthorised use (Section 154) : Section 154 deals with liability of bailee making unauthorised use of goods bailed. It reads as follows -

"If the bailee makes any use of the goods bailed which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them."

Illustrations :

(a) A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.

(b) A hires a horse in Calcutta from B expressly to march to Benares. A rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. A is liable to make compensation to B for the injury to the horse.

The Bailee must not misuse or make unauthorised use of the goods bailed. If he does so, he is liable to pay compensation to the bailor. *Eg.* 'A' lends his horse to 'B' for his own riding only. But, 'B' allows 'C', his family member to ride the horse. 'C' rides with care. But, the horse accidentally falls and is injured. 'B' is liable to make compensation to 'A' for the injury done to the horse.

iii) To act in conformity with terms and conditions (Sec.153) :— The bailee must act in compliance with the terms and conditions of the contract. Non-compliance leads to the contract becoming voidable at the option of the bailor. *Eg.* 'A' lets to 'B', for hire, a horse for his own riding. But 'B' drives the horse in his carriage. It amounts to non-compliance and 'A' can avoid the contract.

Section 153 provides for termination of bailment by bailee's act inconsistent with conditions. It reads as follows -

"A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

Illustration :

A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. This is, at the option of A, a termination of the bailment.

iv) Not to mix goods (Section 155) : The bailee should not mix the goods bailed with his own goods without the consent of the bailor. When the goods are mixed, they may or may not be separable. If separable, the cost of separation should be borne by the bailee. If the goods mixed are inseparable, bailee has to bear the loss.

Example : 'A' bails 100 bales of cotton marketed with a particular mark to 'B'. 'B', without 'A's consent, mixes the 100 bales with other bales of his own bearing a different mark. 'A' is entitled to have his 100 bales returned and 'B' is bound to bear all expenses incurred in the separation of the bales and any other incidental damage.

Section 155 provides for Effect of mixture, with bailor's consent, of his goods with bailee's. It reads as follows -

"If the bailee, with the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced.

v) To return the goods (Section 160): Section 160 provides for return of goods bailed, on expiration of time or accomplishment of purpose. It reads as follows -

" It is the duty of the bailee to return, or deliver according to the bailor's directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished.

In bailment, the goods are delivered for a specific purpose. After the purpose is accomplished, the bailee has a duty to return the goods to the bailor (or dispose of them as directed by the bailor).

9. Rights of Bailee

The rights of the Bailee may be explained under the following heads :

i) Right to recover expenses (Section 158).

ii) Right to recover compensation (Section 164).

iii) Right to Lien (Sections 171 & 172); and

iv) Right against third party (Right of subrogation) (Sec. 180).

i) Right to recover expenses (Sec. 158) : The bailee has a right to recover all the expenses incurred and remuneration for the services rendered by him under the contract. Section 158 confers on bailee right to recover necessary expenses incurred on bailment. It reads as follows -

"Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment."

Eg. A leaves his horse with his neighbour, B, for safe custody for one week. B is entitled to recover the expenses incurred by him in feeding the horse.

ii) Right to recover compensation (Sec.164) :— The bailee is entitled to recover compensation from the bailor for the loss sustained. Sometimes the bailor may not be entitled to make the bailment, or to receive back the goods. This may result in some loss to the bailee. The bailee is entitled to recover from the bailor such loss as may be caused due to the above stated reason. The provision in this regard is contained in Section 164, which reads as under :

" The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods, or to give directions respecting them."

iii) Right of Lien (Sections 170 & 171):— The terms 'Lien' means "right to retain the goods till the dues are cleared." The lien is of two types namely (1) General lien; and (2) Particular lien. The general lien entitles the bailee to retain the goods of the bailor for a general balance of account. The particular lien entitles him (bailee) to retain the goods for the services rendered by him (in which remuneration is due).

Section 170 confers on bailee particular lien. It runs as follows-

"Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them.

Illustrations :

(a) A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

(b) A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a threemonths credit for the price. B is not entitled to retain the coat until he is paid.

Section 171, which speaks about 'general lien' reads as under-

"Bankers, factors, wharfingers, attorneys of a High Court and policy-brokers may, in the absence of a contract to the contrary, retain as a security for a general balance of account, any goods

bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to that effect.

It has been noted above that a particular lien is a right to retain those very goods in respect of which some services, etc. are rendered by the bailee. On the other hand, general lien entitles the bailee to retain goods of the bailor "for a general balance of account". According to this right, the bailee may retain not only those goods of the bailor in respect of which some particular services are rendered, but also other goods in the possession of the bailee belonging to the bailor.

Shivam Construction Co. v. Vijaya Bank, Ahmedabad, A.I.R. 1997 Guj. 24 : In this case the bank had given overdraft facility to a partnership firm and its partners for granting overdraft facility. The partners and the firm made a default in repayment of loan inspite of notices given by the bank. It was held that in such a situation, under the terms of the loan, as well as in exercise of the right of "set off" and also by way of banker's "general lien", the bank was entitled to liquidate the Fixed Deposit Receipts and appropriate that amount towards overdraft account.

Smt. K.S. Nagalambika v. Corporation Bank, Virajpet, A.I.R. 2000 Kant. 201 : In this case, it has been held that a bank has a general lien over the Fixed Deposit Receipts of the customer. The bank is entitled to adjust the amount of the FDRs towards the loan account.

iv) Right against third party (Sec.180): If a third person deprived bailee from possession or enjoyment of the goods bailed, he can sue such third party. This right to sue third party is also available to the bailor under the right of subrogation.

Section 180, which confers on bailor and bailee right to sue the third person/wrongdoer runs as follows -

"If a third person wrongfully deprives the bailee of the use of possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

10. Right of Lien or Bailee's Lien (Ss. 170 & 171)

Bailee has a right to exercise lien over the goods bailed to him.

The term "lien" means "right to retain the goods or securities till the debt is cleared". Lien is of two kinds namely:—

A) Particular or Special Lien; and

B) General Lien.

A) **A Particular Lien** gives the right to retain possession only of goods in respect of which the charges or dues have arisen. *Eg.* Tailor's right to retain the cloths till the stitching charges are paid.

The Bailee's lien under Sec. 170 is a particular lien. Such a lien is confined to the particular goods in respect of which labour or skill has been expended by the bailee. The conditions to be satisfied for this particular lien to arise are -

(i) The bailee should have rendered some service involving the exercise of labour or skill in respect of the goods bailed;

(ii) Such services should be rendered in accordance with the purpose of the bailment;

(iii) There should be no contract between the parties excluding lien.

When these conditions are satisfied the bailee acquires a particular lien by which he can retain the goods bailed which he has improved with his labour or skill, until his remuneration is paid.

Section 170, which confers on bailee, the right of particular lien runs as follows -

"Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them.

Illustrations :

(a) A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

(b) A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a three months credit for the price. B is not entitled to retain the coat until he is paid.

It may be noted that a bailee gets particular lien in respect of certain goods only when he has improved it by the exercise of his labour and skill. For example, A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

The relevant English Case on this point is -

Hutton v. Car Maintainence Co. (1915) 1 Ch. 621 : In this case, the plaintiff company maintained the car of the defendant. Some maintenance expenses having become due, the plaintiff company took the car into its possession and claimed lien for the expense. The Court, however rejected its claim because what it did was simply to maintain the car and not to improve it.

It is also necessary, as section 170 provides, that labour or skill exercised must be in accordance with the purpose of bailment. For example, if he has not rendered the service within the time fixed or reasonable time, the bailee will get no lien. Moreover, the right of lien depends on possession of goods over which the, lien is claimed. If the bailee surrenders possession of the goods his right of lien is lost.

B) A **General Lien** is one, which gives right to retain possession until the whole balance of the amount is paid. It extends not only towards the goods pledged as security but also in respect of others. *Eg.* Banker exercises the right of general lien (Sec.171 Indian Contract Act, 1872).

Sections 170 and 171 of the Indian Contract Act, 1872 confer on Bailee both the particular and general liens respectively.

The former i.e. the particular lien U/s. 170 is in respect of which labour or skill has been extended by the bailee. While the latter i.e. the general lien U/s. 171 is in respect of general balance of the account. It is not restricted to any specific goods but extends over all goods of the bailor in bailee's possession. The General Lien may be exercised by certain classes of bailees namely -

i) Bankers

ii) Factors

iii) Wharfingers

iv) Attorneys of a High Court and

v) Policy-Brokers.

The right is available to the above categories of bailees only and none else, "unless there is an express contract to that effect". It means that the parties may, by an express contract between themselves, confer the right of general lien on a bailee, who has otherwise got only a right of particular lien.

According to section 171, bankers can exercise general lien, i.e. they can retain as a security, goods bailed to them, for a general balance of account. This right is available in the absence of a contract to the contrary.

The banker's lien is a general lien and he can retain the goods for the satisfaction of a debt other than the one for which the goods are pledged.

K. Sita v. Corporation Bank, A.I.R. 1999 A.P. 367 : In this case, the question for decision in the writ petition was, whether the respondent bank can exercise general lien over gold ornaments pledged by the petitioner to raise a particular loan, even after repayment of the loan, for the purpose of recovery of another loan subsequently advanced to the petitioner by the respondent bank.

It was held that the banker's lien contemplated by section 171 has an overriding effect on the general provisions of section 174 which provides for relationship between the pawnor and the pawnee in respect of the goods pledged.

The bank, therefore, can retain the pledged ornaments if the debtor had not cleared another loan advanced to the petitioner.

A banker can exercise lien over the fixed deposit receipts which have been given to it by a customer to avail of an overdraft facility.

Shivam Construction Co. v. Vijaya Bank, Ahmedabad, A.I.R. 1997 Guj. 24 : In this case the bank had given overdraft facility to a partnership firm and its partners for granting overdraft facility. The partners and the firm made a default in repayment of loan inspite of notices given by the bank. It was held that in such a situation, under the terms of the loan, as well as in exercise of the right of "set off" and also by way of banker's "general lien", the bank was entitled to liquidate the Fixed Deposit Receipts and appropriate that amount towards overdraft account.

Smt. K.S. Nagalambika v. Corporation Bank, Virajpet, A.I.R. 2000 Kant. 201 : In this case, it has been held that a bank has a general lien over the Fixed Deposit Receipts of the customer. The bank is entitled to adjust the amount of the FDRs towards the loan account.

If, however, the bank knows that the securities belong to a third person and not its customer, he cannot exercise the right of lien in respect of them.

If a customer has different accounts with a bank, the bank has a right to combine the two accounts for the purpose of general lien. For instance, if money is due from the customer on loan amount and there is a balance in the customer's favour on the, current account, the banker may treat the two accounts as one.

Distinction between Particular Lien and General Lien -

Following are the main points of difference between general and particular liens :

(a) The right of particular lien can be claimed by every bailee who has in accordance with the purpose of a bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed provided that there is no contract expressing a contrary intention. On the other hand, the right of general lien can be claimed only by bankers, factors, wharfingers, attorneys of High Courts and policy brokers.

(b) The right of particular lien can be claimed only in respect of goods upon which some labour or skill has been exercised by the bailee. The right of general lien, on the other hand, can be claimed in respect of any goods for any charge due in respect of other goods.

(c) Thirdly, and lastly, the right of particular lien can be successfully claimed if by the exercise of labour or skill,

there has been some improvement of the goods but the same is not necessary in case of general lien.

11. Finder of Lost Goods (Ss. 71, 168 & 169)

The position of a bailee is similar to that of a finder of lost goods. Sections 71, 168 and 169 of the Indian Contract Act, 1872 deal with the position of the finder of lost goods. Section 71 speaks about the responsibility of finder of goods., while sections 168 and 169 deal with the rights of the finder of lost goods.

Meaning : Section 71 says that, when a person finds some goods belonging to another and takes them into his custody, he is called "Finder of lost goods". His position is the same to that of a bailee. He is supposed to take care of the goods found and has an obligation/duty to return them to the real owner. If he does not do so or misappropriates the goods, he is subject to civil and criminal liability. According to Sec.71 of the I.C.Act, 1872 "a person, who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee. Further, according to Sec.403, Indian Penal Code, 1860, "a person, who misappropriates a thing, of which he is a finder, is punishable with imprisonment of either description for a term, which may extend to two years or with fine or with both.

The finder of lost goods has to make necessary efforts to find out the real owner. He can dispose of the goods if they are of perishable nature and pay the amount to the real owner after deducting the lawful charges.

Sections 71, 168 and 169 of the Indian Contract Act, 1872 lay down the provisions relating to the finder of lost goods.

Rights : The rights of the finder of lost goods are enshrined in Sections 168 and 169 of the I.C. Act, 1872.

i) Right to retain : The finder of lost goods has a right to retain the possession of the goods until the true owner is found. He

has a right to take action against any other person (except the true owner), who deprives him of the possession of the goods.

ii) Right of Lien : The finder of lost goods has the right of lien to retain the goods against the true owner until he receives such compensation. Where the owner has offered a specific reward (for the return of the goods lost) he may sue for such reward and may retain the goods until he receives it.

iii) Right to Sue (Sec. 168) : Section 168 confers on the finder of goods, right to sue for specific reward offered. It reads as follows -

"The finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner, but he may retain the goods against the owner until he receives such compensation; and, where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

iv) Right to Sell (S.169) : Section 169 says that, when finder of thing commonly on sale may sell it. It runs as follows -

"When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found, or if he refuses upon demand, to pay the lawful charges of the finder, the finder may sell it -

(i) when the thing is in danger of perishing or of losing the greater part of its value, or

(ii) when the lawful charges of the finder, in respect of the thing found, amount to two-thirds of its value.

According to Sec.169, the finder of lost goods has a right to sell if the true owner is not found despite making all efforts or the true owner refuses to pay the lawful charges.

12. Pledge (Section 172) (Meaning, Definition And Essentials)

MEANING : Pledge is a special kind of bailment. It is also known as 'Pawn'. If the goods are bailed as a security for payment of a debt or performance of a promise, it is called 'Pledge'. The person delivering the goods (Bailor) in this case is called 'Pledger' or 'Pawner'. The person to whom the goods are delivered (Bailee) is called the 'Pledgee' or 'Pawnee'.

DEFINITION : Section 172 of the Indian Contract Act, 1872 defines "Pawn" or "Pledge", "Pawner" and "Pawnee" as 'the bailment of goods as security for payment of a debt or performance of a promise, is called pledge'. The bailor in this case is called the 'Pawner' or 'Pledger'. The bailee is called the 'Pawnee' or 'Pledgee'.

Example:— If a farmer delivers to the Bank 100 bags of wheat as security for obtaining a loan, it is called pledge. The farmer is called pledger or pawner. The Bank is called pledgee or pawnee.

'A' borrows Rs. 10,000/- from 'B' and keeps his gold chain with 'B' as security for the payment of the debt. In this example, the bailment of the gold chain is a 'Pledge' or 'Pawn'. 'A' is the 'Pledger' or 'Pawner' and 'B' is the 'Pledgee or 'Pawnee'.

Essential Elements of the Pledge or Pawn (Sec. 172):

To constitute pledge, the following conditions are to be satisfied.

i) Delivery of Goods

ii) Security for payment of Debt and

iii) The subject matter must be movable property.

i) Delivery of Goods : To constitute pledge, there should be bailment of goods i.e. the delivery of goods from one person to another. The delivery of possession may be actual or constructive.

Reeves v. Copper (1933) Bing NC 136; 132 ER 1057 : In this case, the captain of the ship pledged his chronometer with his employer, the ownership. The captain was allowed to keep the chronometer and to use it for the purpose of a voyage. Later on the captain pledged it again with another person. It was held that the first pledge was valid as it was a case of constructive delivery.

Bank of Chittor v. Narasimhah, A.I.R. 1966 AP 163 : In this case, the bank allowed the property pledged to them (a cinema projector and accessories) to remain with the pledgers who sold it to a third person. It was held that it was a case of constructive delivery and therefore the sale was subject to the pledge.

ii) Security for payment of Debt : To constitute pledge, the purpose of bailment is to make the goods bailed to serve as the security for the payment of a debt, or performance of a promise. (In simple words, the goods are delivered as security for the payment of a debt or performance of a promise).

***Bank of India v. Binod Steel Ltd*, A.I.R. 1977 M.P. 188 :** In this case, it has been held that when certain movables have been pledged by a company to a bank, they cannot be attached and sold for satisfaction of claims of other creditors of the company without first satisfying the claim of the bank.

iii) Movable property : In pledge, the subject matter of the property must be a movable property, which includes goods, chattels, valuables and documents.

13. Bailment and Pledge

Both bailment and pledge have some common features. In the former, there is a delivery of goods for some specific purpose., while in the latter, the delivery of goods is as security for payment of a debt. Following are the notable points of distinction between the two -

Distinction between Bailment and Pledge:

Bailment	Pledge
1. Sections 148 to 171 of the I.C. Act deal with bailment.	1. Sections 172 to 181 of the I.C. Act deal with pledge.
2. It is made for any purpose	2. It is made for specific purpose.
3. The bailee can use the goods	3. Pledgee cannot use the goods.
4. The bailee has no right to sell the goods bailed.	4. The pledgee/pawnee has a right to sell the goods pledged if the pledger could not (fails to) redeem them within the stipulated period/time.
5. Bailee can exercise lien on goods only for labour and service	5. Pledgee can exercise lien even for non payment of interest.

14. Pledge and Hypothecation

The expression 'Hypothecation' has not been defined in the Contract Act. It is a kind of mortgage. It means "to place or assign as security under an arrangement (or to mortgage). In hypothecation, the possession of the movable property is retained by the owner and certain rights over the property are vested in the person in whose favour the property is hypothecated.

Distinction between pledge and hypothecation :

Following are the notable points of distinction between the pledge and hypothecation -

Pledge	Hypothecation
1. In pledge, there is a delivery of the movable property.	1. In hypothecation, there need not be a delivery of the property.
2. The property is in the possession of the pledgee.	2. The property need not be in the possession of the hypothecatee.
3. Pledge is a legal charge.	3. Hypothecation is an equitable charge.
4. Pledge is a genus.	4. Hypothecation is a species of the pledge.

Note :— Bailment and Pledge are almost one and the same. In case of the former, goods are not delivered as security, while in the latter (pledge) the goods are delivered as security. The rights and duties of the Bailor and Bailee are identical to the rights and duties of the pledger/pawner and pledgee/pawnee respectively.

15. Rights and Duties of Pawnee and Pawnor

If the goods are bailed (delivered) as security for payment of a debt or performance of a promise such bailment is called "Pledge". The bailor is called 'pledger' and the bailee is called 'Pledgee'. Pledge, Pledger and Pledgee are also known as Pawn, Pawnor and Pawnee respectively.

Rights of Pledgee or Pawnee (Ss.173 to 176):— A pawnee has the following rights.

1. Right to retain the goods pledged (Ss. 173 & 174).
2. Right to recover extraordinary expenses (S.175)
3. Right to sue and to sell the pledged goods (S.176)

1. Right to retain or the Right of retainer (Ss.173 & 174) : Sections 173 and 174, which confer on pawnee, the right of retaining or the right to retain reads as follows -

Pawnee's right of retainer (Sec. 173) : The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interests of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Pawnee not to retain for debt or promise other than that for which goods pledged - presumption in case of subsequent advances : The pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.

In simple words, Sec. 173 confers on the pawnee, a right to retain the goods pledged not only for payment of the debt or performance of the promise, but also for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged. However, he cannot retain any other goods other than the goods pledged. This right of pawnee is also termed as the "Pawnee's right of particular lien". (Sec. 174).

Smt. Aratibala Mohanty v. State Bank of India and others, A.I.R. 1991 Ori 260 : In this case, the petitioner had taken the loan on the pledge agreement. On account of order of attachment from the court and seizure of the property, the Bank which had the obligation to deliver back the possession of the goods when the pawnee exercised her right of redemption, did not discharge that obligation. The Division Bench of the Orissa High Court held that the bank as the pawnee having refused to perform its obligation of redelivering the goods on debts being satisfied cannot claim any interest for the said period.

2. Right to recover extraordinary expenses (Sec.175): Section 175 confers on pawnee, right to recover extraordinary expenses from the pawnor. It runs as follows -

"The Pawnee is entitled to receive from the Pawnor, extraordinary expenses incurred by him for the preservation of the goods pledged."

Example : If the Pawnee has to arrange for a bank locker for the safety of the goods or he spends some amount for insuring the goods, he can recover such expenses from the Pawnor.

Haridas Mundhra v. National and Grindlay's Bank ltd, A.I.R. 1963 Cal 132 at p. 134 : In this case, Bachawat J. aptly remarked : " The right to retain the pawn and the right to sell it are alternative and not concurrent rights. While the pawnee, he does not sell; and when he sells he does not retain. But the pawnee has the right to sue on the debt or on the promise concurrently with his right to retain the pawn or to sell it. The retention of the pawn does not exclude his right of suit since the pawn is collateral security only. Nor does the sale of the pawn destroy his right; the pawner is still liable on the original promise to pay the balance due."

3. Right to sue and to sell the pledged goods (Sec.176): Section 176 confers on pawnee, right, where pawnor makes default. It reads as follows -

"If the pawnor makes default in payment of debt, or performance; at the stipulated time of the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale.

If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor."

This section confers the following rights on the pawnee, on the pawnor's default in fulfilling his promise :

(i) he may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security, or

(ii) he may sell the thing pledged, on giving the pawnor reasonable notice of the sale.

In simple words,if the pawnor makes default in payment of the debt or performance of the promise in respect of which the goods were pledged, the pawnee may sue the pawnor or sell the goods pledged after giving reasonable notice to the pawnor.

Bank of Bihar v. The State of Bihar, A.I.R. 1971 Sc 1210 : In this case, it was held that the pledgee has a right to be paid in priority to third parties who are unsecured creditors of the pledge. See also comments under Sec. 181 for rights against trespassers.

Duties of Pawnee :— The duties of Pawnee are identical to that of a bailee as stated below :

1. The Pawnee must take care of the goods pledged as a reasonable and prudent man to take care of the goods bailed under similar circumstances.
2. He must not make unauthorised use of the goods pledged.
3. He should not mix the goods pledged with his own goods without the consent of the pawnor.
4. He has a duty to return the goods pledged on payment of the amount due or on performance of his promise.
5. He must act in conformity with terms and conditions of the contract of pledge/pawn.

Rights of Pawnor (Sec.177) :— Section deals with defaulting pawner's right to redeem. It reads as follows -

"If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them, but he must, in that case, pay, in addition, any expenses which have arisen from his default.

Sec. 177 confers on the Pawnor, the following rights.

1. He has a right to redeem (to set back) the goods pledged. This right is called the right of redemption.
2. He has a right to insist upon the pawnee for proper preservation and maintenance of the goods pledged.

Duties of the Pawnor :— The rights of the pawnee are corresponding to the duties of the pawnor as stated earlier/above.

16. Pledge by Non-Owners *(Nemo dat quod non habet)*

The general rule is that, it is only the real owner, who can ordinarily create a valid pledge. This rule has been enshrined in the Latin maxim "Nem odat quod non habet". This principle aims to protect the proprietory interest of an individual. In other words, a person, who has a valid title over the goods (property) i.e. owner of the goods alone can create a valid pledge. However, this rule is subject to certain exceptions.

Following are such exceptional cases in respect of which a non-owner can create a valid pledge.

1. Pledge by Mercantile Agent (Sec. 178)
2. Pledge by a person in possession of goods under voidable contract(Sec. 178A)
3. Pledge by a co-owner
4. Pledge by a person having limited interest (S.179)

5. Pledge by a seller in possession of goods after sale; and

6. Pledge by a buyer in possession of goods.

1. Pledge by Mercantile Agent (Sec.178) : Section 178 deals with pledge by Mercantile Agent. It reads as follows -

"Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not authority to pledge.

Explanation.: In this section, the expressions 'mercantile agent' and 'documents of title' shall have the meanings assigned to them in the Indian Sale of Goods Act, 1930 (3 of 1930).

A mercantile agent is a person, who by virtue of customary trade practice, is authorised to sell or buy goods belonging to others. He may be entrusted with the possession of the goods or title deeds. Therefore, any pledge made by him is valid.

2. Pledge by a person in possession of goods under voidable contract (Sec. 178 A): Section 178 A (substituted by Act 4 of 1930) provides for pledge by person in possession under voidable contract. It reads as follows -

"When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19 A, but the contract has not been rescinded at the time of the pledge, but the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title. Pledge by such person is valid provided:

a) the contract has not been rescinded before the contract of pledge;

b) the pawnee acts in

c) the pawnee has no notice as to the pawnor's defective title.

3. Pledge by Co-Owner : A Co-owner, who is in possession of the goods, with the consent of the other co-owner/co-owners can pledge the goods.

4. Pledge by a person having limited interest (Sec.179): Section 179 deals with pledge, where pawnor has only a limited interest. It reads as follows -

"Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest."

In simple words, if a person has a limited interest in the goods, he can pledge the goods to the extent of his interest.

Example : 'A' gives/delivers a piece of cloth to 'B', a tailor for stitching a shirt. The stitching charge Rs. 50/- is not paid by 'A' and 'B' exercises (particular) lien over the shirt to the extent of Rs. 50/- In other words, 'B' has a limited interest in the shirt. If 'B' pledges the shirt to 'C' for Rs. 100/- the pledge is valid to the extent of Rs.50/-. If 'A' pays Rs.50/- to 'C', 'C' is bound to return the shirt to 'A'.

5. Pledge by a seller in possession of goods after sale:— A seller, who is in possession of the goods after sale, is no more the owner. However, pledge of the goods by him is valid, provided the pledgee/pawnee had acted in good faith and had no notice as to the previous sale.

6. Pledge by a buyer in possession of goods :— A buyer who is in possession of the goods before payment of the price in full can make a valid pledge provided:

i) the pawnee acts in good faith; and

ii) he has no notice as to the pawner's defective title.

Case Comment (Part-C)

Q) Discuss the facts and law laid down in the case of *Bank of Bihar vs. State of Bihar* (N.U., April '99, Part-C, Q.No.16).

Ans. Instant case refers to "the rights of the pawnee under Sections 173 and 180 of the Indian Contract Act, 1872.

Bank of Bihar vs. State of Bihar, AIR 1971 SC 1210

Facts of the Case:— The plaintiff bank the pawnee in this case, advanced a loan to a sugar factory, D_2 against the security of sugar bags in D_2's godown. The godown was locked and the key was handedover to the bank. There were some sums payable by D_2 to D_1, the State Government (State of Bihar). D_1 sued D_2 and obtained decree for attachment of the sugar godown. D_1 broke open the sugar godown and seized 5000 maunds of sugar (under a seizure order of the Rationing Authority). The sale proceeds were appropriated for the recovery of arrears of cane cess. The plaintiff bank, as pawnee, approached the Supreme Court claiming the amount from the State Government.

Questions / Issues Involved :— The questions involved in the instant case are :

1. Whether the plaintiff bank as pawnee had a prior and special rights in the goods?
2. Whether the plaintiff bank is entitled to get the sale proceeds from the State Government?

The Supreme Court answering the above questions in affirmative decided / held in favour of the plaintiff bank on the following grounds.

The plaintiff bank, as pawnee is entitled to some special rights under Sections 173 and 180 of the Indian Contract Act 1872, which read as follows:

Section 173 confers on pawnee, the right of retainer. The plaintiff bank as pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but also for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Section 180 confers on bailee (pawnee) a right to sue the third party, who deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee (pawnee) is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against the third person for such deprivation or injury.

With regard to the first question, by virtue of the provisions enshrined under Sections 173 and 180 of the I.C. Act, the plaintiff bank as the pawnee and secured creditor had special rights in the goods. So long as their (pawnee's) claim is not satisfied, no other creditor of the pawnor has any right to take away the goods at their price.

With regard to the second question, the Crane Commissioner, representing the State Government was only an unsecured creditor and so was entitled only to the surplus amount (residue) if any, after meeting/satisfying the secured creditor, the plaintiff bank. Therefore, the plaintiff bank is entitled to get the sale proceeds from the State Government and accordingly, the Supreme Court directed in favour of the plaintiff bank.

Decision:— The Supreme Court held that the Crane Commissioner representing the State of Bihar, being an unsecured creditor could claim only against the surplus (residue) after meeting the claims of the secured creditors. The court held that the plaintiff bank, being a secured creditor and a pawnee having special rights (as provided for under Sections 173 and 180 of the I.C. Act) is entitled to get the sale proceeds from the State Government.

Problem

Reliance Bank Ltd., advanced a loan to Bombay Textile Co., D2 against the security of cotton bales in their godown. The godown containing the cotton bales was locked and the key was handed over to the bank. There were some arrears of commercial tax payable by D2 to the State of Maharashtra, D1. D1 broke open the godown and seized the cotton bales against the orders of the Tax Authorities. The sale proceeds were appropriated for the recovery of tax arrears. Reliance Bank Ltd., P sued D1 claiming the sale proceeds from the State Government - Decide.

Ans: Instant problem attracts Sections 173 and 180 of the Indian Contract Act, 1872, which confer some special rights on pawnee/pledgee in a contract of pledge/pawn.

The relevant leading case on which the problem is framed is:

Bank of Bihar vs. The State of Bihar, AIR 1971 SC 1210

The above problem may be answered with reference to the rights of pawnee under Sections 173 and 180 of the I.C. Act and the decision of the Supreme Court in the above case as detailed below:

Write now, the meaning and definition of pawn, pawnor and pawnee in brief and then write about the case, *Bank of Bihar vs. The State of Bihar* in detail as above.

In view of the above, the plaintiff bank, being a pawnee and secured creditor gets some special rights in the property/goods pledged and therefore, is entitled to claim the sale proceeds of the goods from the State Government.

Problem :— Raju lends a horse to Dany for his own riding only. Dany allowed Gopal, a member of his family to ride the horse. Gopal rides with care but the horse accidentally falls and injured. Decide whether Raju is allowed to make compensation (A.U. Sept/ Oct.99, Part-C, Q.No. 3 - Clue : Sec.154 : Liability of bailee making

unauthorised use of the goods bailed - Raju is entitled to get compensation i.e. Dany, the bailee in this case is liable.)

Questions and How to Answer

Q) What is bailment ? (N.U. April, '99, Part-A, Q.No.4).

Q) Define pledge ? (S.V.U., Nov., '99, Part-A, Q.No.2)

Q) Explain the duties of bailor? (N.U. April, 99, Part-A, Q.No.5)

Q) State the duties of a bailee? (S.V.U. Nov. '99, Part-A, Q.No.3).

Q) Define Bailment and distinguish it from pledge? (A.U.,Sept./Oct.1999, Part-A, Q.No.2).

Q) What is the difference between the contract of bailment and pledge? Explain the rights and duties of bailee? (A.U. Model Question Paper, Part-B, Q.No.1 & N.U., April, '99, Part-B, Q.12).

Q) What are the rights of finder of lost goods. (A.U. Model Question Paper, Part-A, Q.No.3 & A.U. Sept./Oct. '99, Part-A, Q.3 & Part-B, Q.No.4).

Q) What is the nature of Bailee's Lien? Distinguish between General Lien and Particular Lien?

Ans. It is a direct question. Write meaning and definition of bailment and then write about Bailee's Lien in detail.

Q) Stoppage in transit is an extension of the Rights of Lien - Explain.

Ans. The question refers to nature/position of bailee's lien in a contract of bailment. Sections 170 and 171 of the Indian Contract Act lay down the provisions relating to bailee's lien. (Write now about meaning and definition of bailment and then Bailee's lien in detail).

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Lecture - IV

CONTRACT OF AGENCY

Chapter X containing sections 182 to 238 of the Indian Contract Act, 1872 lay down the provisions relating to the contract of 'Agency'. This lecture covers -

1. Contract of Agency : Meaning & Definition
2. Essential Elements of Agency.
3. Kinds of Agents
4. Creation of Agency
   - i) Agency by Express Agreement (S. 186)
   - ii) Agency by Implied Agreement (S. 187)
     - A) Agency by Estoppel
     - B) Agency by Holding Out
     - C) Agency by Necessity
     - D) Distinction between Agency by Necessity and Agency by Estoppel.
   - iii) Agency by Ratification and
   - iv) Agency by Operation of Law.
5. Delegation of Authority
6. Co-Agent or Substituted Agent
7. Rights and Duties of Agent
8. Personal Liability of Agent; and
9. Termination of Agency.

1. Contract of Agency
Meaning & Definition

Meaning :— When a person appoints another to act on his behalf with a third party, it is called 'Agency'. The person who appoints is called 'Principal'. The other person, who is appointed is called 'Agent'. The contract between them (i.e. Principal and Agent) is called 'Contract of Agency'.

Definition :— 'Agency is the legal relationship between an agent and Principal; to bring the principal into legal relationship with the third party.'

Example :— 'A' appoints 'B' to purchase some property on his behalf. Here, 'A' is principal and 'B' is Agent. The relationship between 'A' and 'B' is called Agency.

Definition of Agent and Principal (Sec.182) : Section 182 of the Indian Contract Act, 1872 defines Agent and Principal as follows -

"An 'Agent' is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done or who is so represented is called the 'Principal'."

Who may employ agent (Sec. 183) : Section 183 says that "any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent." In other words, any person, who is a major and is of sound mind may appoint an agent.

Who may be an agent (Sec. 184) : Section 184 says " As between the principal and third persons, any person may become an agent, but no person who is not of the age of majority and sound mind can become an agent, so as to be responsible to the principal according to the provisions in that behalf herein contained."

Section 185 lays down that consideration is not necessary for creation of an agency. However, "Knowledge of the Agent is knowledge of the Principal" is the basis for the appointment of an agent. Knowledge and experience of an agent on the particular work is very important factor. A person appointed as an agent uses his knowledge and skill for his principal, for which the agent is entitled for a remuneration, commission etc., as agreed between them, or as per the customs and usages.

2. Essential Elements of Agency

To constitute Agency, the following ingredients are to be satisfied -

i) Principal must be competent to contract (S. 183)

ii) Any person may become an Agent (S. 184)

iii) Consideration not necessary (S.185)

i) Principal must be competent to contract (S. 183) : Section 183 envisages qualification to act as principal as enshrined under Sec. 11 of the Indian Contract Act, 1872 namely a) age of majority and b) soundness of mind. Section 183 runs as follows -

"Any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent."

According to Section 11 of the Act, every person is competent to contract who is of the age of majority and of sound mind, and is not disqualified from contracting by any law to which he is subject. Thus principal should be competent to contract. It may however, be noted that Section 183 requires a person to be major and of sound mind to employ agent. It does not speak of third requirement, i.e. not being disqualified from contracting by any law to which he is subject. It appears that if a person is of sound mind and is a major, he may employ an agent irrespective of the fact that he may be deprived of his right of contracting generally by any statute. It

is, however, clear that a minor cannot employ an agent and the appointment of an agent by a minor will be void.

ii) Any person may become an Agent (S. 184) : Section 184 says that any person can be an agent. It reads as follows -

"As between the principal and third persons any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf herein contained."

Anson, in his Law of Contract (23rd Edition, p. 543) aptly remarked that "Full contractual capacity is not necessary to enable person to represent another as agent. An infant can be an agent, although his capacity may shield him from liability to his principal". Thus although a minor cannot employ an agent yet he may become an agent but since he is incompetent to contract, he will not be responsible to his principal.

iii) Consideration not necessary (S.185) : Section 185 lays down that consideration is not necessary for creation of a contract of agency. This provision may be treated as 4th exception to the general rule, "a contract without consideration is void". In other words, as per these exceptions, a contract without consideration is valid.

3. Kinds of Agents

Agents may be classified under the following heads -

1. *Del Credere* Agents
2. Pakka Adatia
3. Factor
4. Broker
5. Auctioneers.

1. *Del Credere* Agents : Generally, the function of an agent is over after a contract is established between his principal and a third person. He is not answerable to his principal for the failure of the third person to perform the contract. A *del credere* agent constitutes an exception to this rule.

A del credere agent is a mercantile agent who for extra commission takes the responsibility of that person with whom he contracts on behalf of the principal will perform their contract. Thus if such a person fails to perform his contract, a del credere agent will be responsible to the principal for the same.

2. Pakka Adatia : A Pakka Adatia is an agent to whom goods are handed over by the principal and then the actual sale of the goods becomes the agent's own affair such an agent is particularly in vogue in Bombay markets. A Pakka Adatia has authority to enter into transactions in his own name. He may contract as a principal rather than as an agent. Thus a Pakka Adatia is one who undertakes the business of his principal but the transaction or contracts he enters into are his own affairs. Thus, in certain respects a Pakka Adatia may be taken to be a principal in that he can allocate the transaction to himself and himself buy from and sell to his constituent as a principal.

3. Factor : A factor is a mercantile agent who is entrusted with the possession of the goods for the purpose of sale. He has also the power to sell goods on credit and also to receive the price from the buyer. If the owner has put a factor in possession of the goods or the document of title but without authorising him to sell the goods, the sale of goods by him will convey a good title to a bona fide buyer. According to Section 171 of the Indian Contract Act, 1872, a factor has right of general lien over the goods belonging to his principal, which are in his possession, for the general balance of account.

4. Broker : A broker is an agent who has an authority to negotiate the sale or purchase of goods on behalf of his principal,

with a third person. Unlike a factor, he himself has no possession of the goods. He merely makes the two parties to enter into a contract. He gets his commission whenever any transaction materialises through his efforts.

5. Auctioneers : An auctioneer is an agent to sell property at a public auction. He is primarily an agent for the seller, but upon the property being knocked down he becomes also the agent of the buyer. He is a mercantile agent within the meaning of section 2(9) of the Sale of Goods Act. If the owner of the goods puts him in possession of the goods although the authority to sell has not been conferred in him, a buyer in good faith from such an auctioneer will get a good title in respect of the goods. Thus, if he has been authorised to sell the goods only subject to a reserved price but he sells the same to an innocent and bona fide buyer below the reserved price, the buyer will get a good title in respect of such goods.

4. Creation of Agency

The word 'agency' is used to connote the relation which exists where one person has an authority or capacity to create legal relations between a person occupying the position of principal and third parties. The relation of agency arises, whenever one person, called the 'agent' has authority to act on behalf of another called the 'principal' and consents to act. Whether that relation exists in any situation depends not in the precise terminology employed by the parties to describe their relationship. If an agreement in substance contemplates the alleged agent acting on his own behalf and not on behalf of the principal, then although he may be described in the agreement as an agent, the relation of agency will not have arisen. Conversely, the relation of agency may arise despite a provision in the agreement that it shall not. An act done by an agent on behalf of the principal binds the principal towards a third person. The relationship of Principal and Agent between the person represented and the person representing has to exist in order that the principal's liability towards the third person, arises.

Agency may be created under the following ways :

1. By Express Agreement (Section 186).
2. By Implied Agreement (Section 187)
   (A) Agency of Estoppel.
   (B) Agency by Holdingout.
   (C) Agency by Necessity.
3. By Ratification (Section 197).
4. By Operation of Law.

1. By Express Agreement (Section 186) :— According to section 186 of the Indian Contract Act, 1872, the contract of agency may be express or implied. Express in the sense, it may be oral or in writing. It is a practice in many cases, to appoint agents by using the power of attorney on a stamped paper.

2. By Implied Agreement (Section 187) : Section 187 defines express and implied authority as follows-

"An authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case."

An Implied Agency may be created from the conduct, situation or relationship of the parties. It may be inferred from the circumstances of the case. Implied agency includes :

A) *Agency by Estoppel;*

B) Holding out; and

C) Necessity

A)Agency by Estoppel :— It is based on the 'Doctrine of Estoppel'. If the principal by his conduct or statement leads another

person to believe that a person is his agent, he can not deny him as his agent later. *Eg.* 'A' says 'B' in the presence of 'C' that he is the agent of 'C'. If 'C' does not deny the statement, he can not deny 'A' as his agent later.

Sometimes the agent has neither express nor implied authority to do an act on behalf of the principal, but the principal by his conduct creates an impression in the mind of the third person that the agent has an authority to act on his behalf. In such a case, the principal is liable towards the third person for the acts done by the agent, on the ground of the application of the law of estoppel. The basis of the action is what appears to the third person to be an authority, i.e. apparent or ostensible authority conferred on the agent.

Section 237 of the Indian Contract Act, 1872 speaks about the liability of principal inducing belief that agent's unauthorised acts were authorised. It reads as follows -

"When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligation, if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority."

Illustrations :

(a) A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

(b) A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private orders from A. The sale is good.

B) Agency by Holding out :— It is branch of the Agency by Estoppel. If one person knowingly admits another to act on his behalf, and allows him to do so, later he cannot deny the act of that

person. If he does not want to do so he should express his objection to that act immediately. If he allows him to do the acts on his behalf, later he is estopped, the act becomes valid under agency. This is called the "Doctrine of Estoppel or Agency by Holding Out".

Example : (i) 'A' allowed his servant 'B' to take goods on credit from 'C' and 'A' was making payment. Later, 'A' terminated 'B' as his agent, but the termination was not communicated to 'C'. 'B' as usual, took goods on credit from 'C'. Now, 'A' can not deny 'B' as his agent and avoid payment.

(ii) A was a partner of XYZ company. A placed an order to C for the supply of goods to be supplied to D. C supplied the goods to D. XYZ paid the amount. It is presumed that A has authority to pledge XYZ's credit on a subsequent occasion for goods sent by C to D on the order of A.

(iii) A allowed his wife B to manage his property and to mortgage it. A is bound by her acts.

(iv) A was the shop owner. B managed the shop. B regularly placed orders with C on A's name, and A used to pay them. This practice ran for months. Later, B purchased certain goods from C and absconded from the city. A was liable.

(v) A was the owner of the goods. He handed over the goods to B along with their title to goods. B sold the goods to C, who purchased them in good faith. A was bound by the sale.

(vi) A is the son of B. A gave order for furniture to furniture dealer D. D supplied the furniture and arranged it in the presence of B. B gave certain instructions as to how they should be arranged. B is bound to pay the cost of furniture.

C)Agency by Necessity : Agency of necessity is created in cases of emergencies. In these cases, the persons who perform their services as agents do not seek prior permission or appointment from the principals. The principals are also in certain difficult

situations and they could not give their assent or refusal, but accept the services rendered by such persons. Therefore law confers authority on a person to act as an agent for another, without the consent of that person (principal). Such an agency is called 'Agency by Necessity'.

Matheson v. Smiley (1932) : In this case, an unconscious person was brought by some unknown persons before a surgeon. He attempted to commit suicide. The surgeon tried to save his life. He also incurred huge expenses. The Court held that the surgeon was entitled to recover the medical expenses and service charges.

An agency of necessity is thus created in case of an injured person, who is in need of medical attendance. In certain circumstances, a person will be compelled to act as an agent for others.

Sims & Co. v. Midland Rly. Co. (1913) : In this case, the plaintiff sent certain quantity of butter to a dealer by the defendant railway. Due to a strike, the train was stopped in the middle of the way. The defendant sold butter, it being of perishable nature, and remitted the amount to the plaintiff. The plaintiff sued the defendant for damages. The court held that the defendant acted as an agent in necessity and in good faith and he was not liable.

Prager v. Blastpiel Stamp & Heacock Ltd.(1924) 1 KB 566 : In this case, both the plaintiff and defendant were the dealers in dressed skins. During the first world war, the plaintiff gave the money to purchase certain quantity of dressed skins with an intention to export them to Rumania after peace resumed. The defendant purchased dressed skins with the money of plaintiff. The plaintiff instructed the defendant to store the dressed skins in the defendant's godown until the peace resumed. After one year, the defendant sold them. The plaintiff sued the defendant for cost of the goods and also for damages.

The defendant pleaded that they sold skins in an emergency under the Rule of "Agency of Necessity". the court held that the

nature of the dressed skins was not that perishable character, and that the plaintiff purchased them in war time with an intention to sell after peace presumed. Therefore, there was no emergency and no "agency of necessity" was created. The defendant was held liable.

D) Distinction between Agency by Necessity and Agency by Estoppel :

Despite some similarities, the notable points of distinction between the agency by necessity and agency by estoppel are detailed below -

Agency of Necessity	Agency by Estoppel
1. It is created in emergency.	1. It is created in general.
2. There are no chances of obtaining the principal's consent.	2. The principal gives his consent, by his conduct. There is no express consent. However, the incidence of agency is known to him. He silently admits it.
3. In an agency of necessity, the person who acts as an agent, should take all precautions necessary to perform that act. There are no chances of obtaining the principal's instructions.	3. In this case, the person who acts as an agent, acts according to the 'will' of the principal. There are chances and time, to the principal to intervene in the act, but he does not intervene it, and moreover allows the agent to do the act.
4. The burden of proof lies upon the agent to a great extent that he was compelled to perform that act.	4. The burden of proof lies upon the principal to a great extent that he did not give any consent, and the act was done without his knowledge.

3. Agency by Ratification (Section 196-200) : Sections 196 to 200 of the Indian Contract Act, 1872 lay down the provisions relating to Agency by Ratification. Section 196 refers to right of person as to acts done for him without his authority-Effect of ratification. Section 197 says that ratification may be expressed or implied. Section 198 speaks about knowledge requisite for valid ratification. Section 199 deals with effect of ratifying unauthorised act forming part of a transaction and finally section 200 provides for ratification of unauthorised act cannot injure third person.

Sometimes, a person (Agent) does not act for another (Principal) without his consent or his knowledge. If the act is accepted later, it is said to be ratified. It is called 'ratification'. If the principal ratifies the act of his agent, it is called 'Agency by Ratification'. Eg. 'A' purchased a house for 'B' without his consent. 'B' accepted it later and paid the amount. It is an agency by ratification.

By ratification we mean an act which the principal confirms unauthorised acts of the agent. That is to say, even if the agent enters into a contract without the authority, consent or knowledge of the principal may, if he likes, ratify it and thereby accept the benefits and obligations arising out of such a contract.

Essentials : Ratification to be valid and enforceable, the following ingredients are to be satisfied -

i) The act should be done on behalf of another person. (Sec. 196).

ii) The principal should be in existence, and competent to contract when the act is done.

iii) Ratification may be express or implied.(Sec. 197).

iv) Ratification should be with full knowledge of the facts.(Sec. 198).

v) Ratification should be of the whole transaction.(Sec. 199).

vi) Ratified acts should not be injurious to third person.(Sec. 200).

vii) Ratification should be made within a reasonable time.

4. Agency by Operation of Law :— Sometimes Agency is created by operation of law. When a company is formed, its promoters act as its agents by operation of law. Similarly, partners are the agents of the Partnership Firm.

5. Delegation of Authority

Delegatus non potest delegare 'or'

Authority once delegated can not be further delegated 'or'

Himself a delegate, an agent can not further delegate.

Delegation of Authority :— (Sec. 190) The expression 'Delegation of Authority' means "transfer of authority/power by the superior to the subordinate to act on his behalf". When an agent has undertaken to perform certain duties personally, he is not allowed to delegate his duties to another person. The rule is contained in the maxim 'Delegatus non potest delegare', which means that an agent to whom some authority has been delegated cannot further delegate that authority to another person. The relationship of principal and agent is based on confidence and trust. When the principal has reposed trust in a particular agent, the agent cannot substitute another person in his place. In other words, an agent cannot employ a sub-agent to get the work done through him. An agent, who has undertaken to do some work personally, cannot employ a sub-agent to do the same. However, this rule is subject to an exception under section 190.

Section 190 envisages that an agent cannot delegate unless the custom or trade so permits. It runs as follows -

"An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally,

unless by the ordinary custom of trade a sub-agent may, or, from the nature of the agency, a sub-agent must, be employed."

Example :— When a person (Principal) employs another (agent) to act on his behalf, it is called the 'delegation of authority'. The person (agent) so appointed is called the 'the delegate'.

The general rule is that "an agent, being a delegate can not further delegate his authority". (An agent cannot delegate his duties to another person). In other words, where a work had already been entrusted/assigned to an agent, the work should not be further entrusted by the agent to another person.

Sub Agent : If an agent appoints another person as his agent, he is called sub-agent. In other words, sub-agent is a person employed by the original agent. He acts under the control of the original agent. The relationship between agent and sub-agent is that of the principal and agent.

Definition : According to Sec.191 of the I.C. Act, 'a sub-agent' is a person employed by, and acting under the control of, the original agent in the business of the agency".

Exceptions : Section 190 of the Indian Contract Act, 1872 provides for two exceptions for the appointment of a sub-agent as follows:

1. Where the custom or trade permits the appointment of a sub-agent.

Example :— An advocate, who is engaged to attend to a work in court may delegate it to another advocate.

2. Where the appointment of a sub-agent is necessary for the nature of the work.

In addition to the above, following are some more exceptions recognised by the English Law and are also accepted in India.

i) Where the principal permits him to appoint a sub-agent.

ii) Where the principal is aware of the intention of the agent to appoint a sub-agent and he (principal) does not object to it; and

iii) Where necessity arises for the appointment of a sub-agent.

An agent appointed under any one of the above circumstances, is called "properly appointed sub-agent". He acts under the control of the original agent (Sec.191).

Relationship between Principal and Sub-Agent : The legal relation between the sub-agent and the principal depends upon whether the appointment is proper or improper. When the sub-agent is properly appointed, he can represent the principal as regards parties. So, such third parties can sue the principal. Between the sub-agent and the principal there is no privity of contract. So the sub-agent is responsible for his acts to the Agent and not to the principal. The Agent would be responsible to the principal for the sub-agent's acts. If there is fraud or wilful wrong, however, the sub-agent also becomes directly responsible to the principal(Sec. 192).

When the sub-agent is improperly appointed, the principal is not represented by him and is not bound by his acts. The third parties concerned cannot look to the principal but can only look to the agent for the fulfilment of the contract entered into by them with the sub-agent. Further, the sub-agent is not responsible only to the agent. The Agent would be responsible both to the principal and to the third parties (Sec. 194).

6. Co-Agent or Substituted Agent

Section 194 of the I.C. Act, 1872 deals with the appointment of a Co-agent or Substituted agent. Substituted agent is a person, who is named by the agent with the express or implied authority of the principal. In other words, he is named by the agent at the request of the principal.

Example :— 'A' instructs his agent 'B' to purchase a horse for him. If 'B' engages 'C' at the desire of 'A' for the purpose, 'C' is called substituted agent.

Sub-agent acts under the control of the Agent, while the substituted agent is not answerable to the Agent, and acts under the Control of the Principal.

Distinction between Sub-agent and Substituted-agent : A sub-Agent is a person who is under the control of the original agent (Sec. 191). Such a person can be properly appointed when the custom of trade permits such appointment or the nature of the agency necessitates such employment (Sec. 196). A substituted agent, on the other hand, is a person who is named by the Agent for performing such part of the business of the agency as is entrusted to him (i.e. the substituted Agent). A substituted agent can be appointed by the agent only when the principal has given him express or implied authority to do so (Sec. 194). Following are the notable points of distinction between the sub-agent and substituted agent.

Sub-agent	Substituted-agent
1. He works under the control of the Agent and hence, he is the agent of the Principal.	1. He works under the control of the Principal and is an agent of the Agent.
2. There is no privity of contract between the principal and sub-agent.	2. There is privity of contract between the principal and substituted agent.
3. He is responsible to the Agent.	3. He is responsible to the Principal.
4. The Agent is responsible for the acts of the sub-agent.	4. The Agent is not responsible for the acts of the substituted-agent.

7. Rights and Duties of Agent

The rights and Duties of the Agent are corresponding to the duties and rights of the Principal.

Duties of an Agent :— An agent owes a number of duties to his principal as embodied in Sections 211 to 221 of the I.C. Act.

1. Duty to conduct the principal's business (Sec.211):— An agent has a duty to act according to the directions of his principal, otherwise he is liable. If there are no such directions, he is bound to conduct the business according to the custom which prevails in doing business of the same kind and place where the agent conducts such business. If the agent does not conduct the business according to the directions of the principal or in its absence according to the prevalent custom, he will be liable for any loss sustained and will also be bound to account for any profit accruing in the business.

Section 211 imposes on agent, duty in conducting principal's business. It runs as under -

"An agent is bound to conduct the business of his principal according to the directions given by the principal, or in the absence of any such directions according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

Illustrations :

(a) A, an agent engaged in carrying on for B a business, in which it is the custom to invest from time to time, at interest, the moneys which may be in hand, omits to make such investment. A must make good to B the interest usually obtained by such investment.

(b) B, a broker in whose business it is not the custom to sell on credit, sells goods of A on credit to C, whose credit at the time was very high. C, before payment, becomes insolvent. B must make good the loss to A.

Section 211 of the Indian Contract Act, 1872 only says that an agent is bound to conduct the business of his principal according to the directions of the latter, or in the absence of any such direction, according to the customs which prevail in doing business of the same kind. It does not speak of any notice at all. The agent is, however, not bound to take any separate or special care. This has been held in ***Padam Parshad v. The Punjab National Bank Ltd., A.I.R. 1974 P & H 22***, wherein the dealer, after having consigned the goods, handed over the receipt to the Bank with a Hundi and instructed to collect the amount from the consignee and to hand over the receipt to the consignee. The Bank sent the receipt by ordinary post and the receipt was lost in the transit. It was submitted that the documents of this nature should have been sent by registered post because even apart from the terms of the agreement, the Bank which was the agent of the plaintiff, had to act like a prudent man who would have ordinarily sent such like documents by registered post. It was held that "this argument would not be available to the appellant, because the parties had to be bound by the terms of the agreement itself. It is not a case where there was no written agreement and the agent was supposed to act on his own. If according to the agreement, the defendant was not required to send the documents by registered post, he was not duty bound to do so.

2. To act with reasonable care and skill (Sec.212): Section 212 enunciates that the agent must have skill and deligence, while conducting/performing the business of agency. It reads as follows-

"An agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business unless the principal has notice of his want of skill.

The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill, or misconduct, but not in respect of loss or damage which is indirectly or remotely caused by such neglect, want of skill, or misconduct."

Illustrations :

(a) A, a merchant in Calcutta, has an agent, B, in London, to whom a sum of money is paid on A's account with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money becomes insolvent. B is liable for the money and interest, from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss - as e.g. by variation of rate of exchange - but not further.

(b) A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B, at the time of such sale, is insolvent. A must make compensation to his principal in respect of any loss thereby sustained.

(c) A, an insurance-broker employed by B to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good the loss to B.

(d) A, a merchant in England, directs B, his agent at Bombay, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England.

Soon after her arrival the price of cotton rises. B is bound to make good to A profit which he might have made by 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

An agent is under a duty to conduct the business of agency with reasonable deligence and skill, he possesses. Otherwise, he is liable to make compensation to the principal in respect of the loss as a consequence of his neglect.

Jayabharathi, Corporation v. Sv. P.N.S.N. Rajesekar Nadar, A.I.R. 1992 SC 596 : In this case, the defendant respondent grossly misconducted himself in first communicating to the applicant that the goods had been purchased for him at the rate of Rs. 36/- per pound when they had not been and further in another communication to have told him that those goods would be despatched the moment the strike of transporters was over. His turning around to say that in fact the goods could not be purchased by him at all as their delivery was dependent on a third party and which third party was dependent on yet another party for delivery of goods appears to us an afterthought. For such neglect and misconduct of the agent misinforming his principal his conduct, squarely comes within the wide terms of section 212 of the Indian Contract Act, 1872 and he therefore must bear the burden to pay damages.

3. To render proper accounts (Sec.213): Section 213 imposes an obligation on agent that, he(agent) is bound to render proper accounts to his principal on demand.

4. To communicate difficulties (Sec.214): It is the duty of an agent, in cases of difficulty, to use all reasonable deligence in communicating with his principal, and in seeking to obtain his instructions.

5. Not to deal on his own account (Sec.215): Section 215 deals with right of principal when agent deals, on his own account, in business of agency without principal's consent. It reads as follows -

"If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows, either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him.

Illustrations :

(a) A. directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale, if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

(b) A directs B to sell A's estate. B, on looking over the estate before selling it, finds a mine on the estate which is unknown to A. B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A allows B to buy, in ignorance of the existence of the mine. A, on discovering that B knew of the mine at the time he bought the estate, may either repudiate or adopt the sale at his option.

An agent should not without the consent of the principal, deal on his own account with the business of the agency. If he does so, the principal can claim any benefit resulting from the transaction or repudiate the transaction, if he finds that, it is disadvantageous to him.

6. Not to make secret profits (Sec.216): Section 216 deals with Principal's right to benefit gained by agent dealing on his own account in business of agency. It reads as follows -

"If an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction."

Illustration :

(a) A, directs B, his agent, to buy a certain house for him. B tells A that it cannot be bought, and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he gave for it.

An agent, without the knowledge of his principal, should not deal in the business of agency on his own to make secret profits. If so, the principal is entitled to claim such profits. Eg. 'A' directs his agent 'B' to buy a land for him. 'B' tells 'A', that it cannot be bought and buys for himself. 'A' can compel his agent 'B' to sell it to 'A' for the same price.

Happisley v. Knee Brothers, (1905) 1 K.B. 1 : In this case, the defendants, auctioneers, were engaged by the plaintiff for the sale of certain property. The plaintiff agreed to pay them certain commission and certain other expenses. While charging the full amount from the plaintiff, they did not deduct the discount received from printers and advertisers honestly believing that they could keep the said discounts themselves. It was held that the defendants were bound to account to the plaintiff the said discounts received by them.

7. Not to disclose confidential matters :— An agent has a duty to maintain the secrecy of the business of agency and should not disclose the confidential matters. Otherwise, he is held liable.

8. Not to delegate authority (Sec.190):— Sec.190 says that, an agent, being a delegate, cannot delegate his duties to another person unless by the ordinary custom of trade, a sub-agent may, or from the nature of the agency, a sub-agent must be employed. This rule is enshrined in a Latin maxim "delegatus non potest delegare". In other words, an agent, being a delegate, cannot further delegate. In other words, an agent cannot appoint further, an agent for himself i.e. sub-agent.

9. To pay the amounts received for the principal (Sec.218):— An agent has a duty to pay to the principal all sums received by him on account of the principal after deducting his dues.

***Narayan Chandra Ghosh v. Biswajit Lahiri*, A.I.R. 2006 Cal. 94** : In this case, the plaintiff filed a suit against the defendant owner of a vessel and his agent for short landing of goods. It was held that the agent who is said to have a limited responsibility of loading and un-loading cannot be made liable unless material is placed before the court to show that the agent has agreed to take the responsibility in making the delivery.

Rights of an Agent :— An agent has the following Rights against the principal.

1. Right to receive remuneration (Sec.219): According to section 219, an agent is entitled to his agreed remuneration or commission. If the amount of remuneration/commission is not fixed in advance, he is entitled for a reasonable remuneration. An agent, who is guilty of misconduct in the business of agency, is not entitled to any remuneration.

Section 219 operates when agent's remuneration becomes due. It runs as follows -

"In the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act; but an agent may detain moneys received by him on

account of goods sold, although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.

2. Right of lien (Sec.221): Section 221 confers on agent, right of lien. Lien means right to retain the property or goods till the dues are cleared/paid. An agent has a right of lien against the goods, papers and other property, whether movable or immovable of the principal till his commission and other payments are made to him.

Section 221 runs as follows -

"In the absence of any contract to the contrary, an agent is entitled to retain goods, papers, and other property, whether movable or immovable, of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him.

3. Right of indemnity (Sec.222): Section 222 confers on agent, right of indemnity. Indemnity means promise to make good the loss. If the agent suffers any loss in discharge of his duties, he has a right to indemnify such loss from the principal.

Section 222 runs as follows -

"The employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him."

Illustrations :

(a) B, at Singapore; under instructions from A of Calcutta, contracts with C to deliver certain goods to him. A does not send the goods to B, and C sues B for breach of contract. B informs A of the suit, and A authorises him to defend the suit. B defends the suit, and is compelled to pay damages and costs, and incurs expenses. A is liable to B for such damages, costs and expenses.

(b) B, a broker at Calcutta, by the orders of A, a merchant there, contracts with C for the purchase of 10 cakes of oil for A. Afterwards A refuses to receive the oil, and C sues B. B informs A, who repudiates the contract altogether. B defends, but unsuccessfully, and has to pay damages and costs and incurs expenses. A is liable to B for such damages, costs and expenses.

4. Right of compensation (Sec.225):— An agent is entitled to claim compensation for the injuries suffered as a consequence or want of skill of the principal. Section 225 provides for compensation to agent for injury caused by principal's neglect. It runs as follows-

"The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill."

Illustrations :

(a) A employs B as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskillfully put up, and B is in consequence hurt. A must make compensation to B.

8. Personal Liability of Agent

An agent is a person, who is employed to bring the principal into contractual relations with third parties. So, the agent, in his own name, can neither enforce nor bound by the contracts concluded by him on behalf of the principal. Therefore, the general rule is that only the principal, who can sue and be sued for the acts of the agent under such contracts. However, there are some exceptions to this rule under section 230. Section 230 says that an agent cannot personally enforce, nor be bound by, contracts on behalf of principal. It runs as follows -

"In the absence of any contract to that effect an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them."

Presumption of contract to the contrary : Such a contract shall be presumed to exist in the following cases :

(i) Where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;

(ii) Where agent does not disclose the name of his principal;

(iii) Where the principal, though disclosed, cannot be sued.

In other words, the agent himself in some exceptional cases acquires certain rights and liabilities so as to enable him to sue and be sued in his own name as stated below :

1. If the principal is residing abroad (Foreign principal);
2. If the Agent does not disclose the name of the principal (undisclosed principal);
3. If the principal is under Legal Disability;
4. If the Agent is an Auctioneer; and
5. Where there is an agreement to that effect.

1. Foreign Principal (Sec.230(1)) : When an agent has entered into a contract for the sale or purchase of goods on behalf of a principal resident abroad, the presumption is that the agent undertakes to be personally liable for the performance of such a contract. If the circumstances indicate that the agent does not want to undertake personal liability, e.g., he discloses the names and particulars of the foreign principal, the agent is not personally liable in such a case (1999).

***U.R. Mohana Krishnan v. Chimanlal Desai & Co.*,A.I.R. 1960 Mad 452 :**

In this case, it was held by the Madras High Court that the agent will be personally liable only where it is established that he contracted on behalf of his principal resident abroad signed on behalf of his principal or that the contract was in fact between an

Indian merchant and an Indian agent who contracted on behalf of a foreign principal.

2. Undisclosed Principal (Sec.230(2)) :— An undisclosed principal is one, whose name is not disclosed by his agent. There are certain circumstances in which the agent says that, somebody is the principal and does not disclose his name. When the principal's name is not disclosed, the agent is presumed to be liable (Sec.230(2)) and hence, he can sue and be sued.

The rule that an undisclosed principal cannot sue upon the contract is enshrined in the principle "that no one can sue upon a contract whose name does not appear in it as a party to it". (Any person who is not a party to the contract cannot sue : privity of contract).

According to section 230(2) "where the agent, does not disclose the name of his principal, the presumption shall exist that he can personally enforce contracts entered into by him and be personally bound by them".

As aptly summed by Chitty (in his Chitty on contracts, 23rd edition,Vol.II, p. 42).

"A very important exception to the rule that an agent is neither entitled to sue nor liable to be sued on a contract made by him in a representative capacity is to be found where the agent makes the contract in his own name without disclosing the fact that he is acting on behalf of another. On such contracts he can sue and be sued in his own name because he is then in contemplation of the law the real contracting party. But the intervention of the undisclosed principal ordinarily puts an end to the agent's right of action."

If an agent, makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has as against the principal, the same rights as he would have had as against the agent if the agent had been the principal.

Exception :— According to Cheshire, the doctrine of undisclosed principal may be regarded as an exception to the above rule of privity of contract under certain circumstances. In other words, an undisclosed principal can sue in his own name provided, the following two conditions are satisfied:

i) At the time of the contract, the agency must have been in existence; and

ii) The contract should not expressly or impliedly confine its operation only to the parties actually named in it.

3. Legal Disability of the Principal :— Where the principal is under a legal disability due to unsoundness of mind etc. (Section 11 I.C. Act) and cannot be sued, the agent is personally liable.

4. If the Agent is an Auctioneer :— If the auctioneer is an agent, he can sue the purchaser directly.

5. Agreement :— If the contract specifically provides for the personal liability of the agent, the agent can sue and be sued in his own name.

9. Termination of Agency
(Revocation of Authority, Ss. 201-210)

Sections 201 to 210 of the Indian Contract Act, 1872 lay down the Provisions relating to the termination of Agency or revocation of Authority. Termination of Agency means putting an end to the legal relationship between principal and agent.

Section 201 provides for termination of agency. It reads as follows -

"An agency is terminated by the principal revoking his authority; or by the agent renouncing the business of the agency; or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated an insolvent under the provisions of any Act for the time being in force for the relief of insolvent debtors."

Section 202 deals with termination of agency, where agent has an interest in subject-matter. Section 203 says that when principal may revoke agent's authority. Section 204 deals with revocation where authority has been partly exercised. Section 205 provides for compensation for revocation by principal, or renunciation by agent. Section 206 makes provision for notice of revocation or renunciation. Section 207 states that revocation and renunciation may be expressed or implied. Section 208 speaks about, when termination of agent's authority takes effect as to agent, and as to third persons. Section 209 deals with agent's duty on termination of agency by principal's death or insanity and section 210 deals with termination of sub-agent's authority.

A contract of agency stands terminated under any of the following means -

1. *By the Act of Parties :*
   a) By Agreement;
   b) By Revocation of the Principal;
   c) By Revocation of an Agent (Renunciation by Agent)
2. *By Operation of Law :*
   a) By Completion of Agency;
   b) By Expiry of time;
   c) Death or Insanity of Principal or Agent;
   d) Insolvency of Principal;
   e) Destruction of the subject matter;
   f) Principal becoming an alien enemy;
   g) Dissolution of Company or Firm.

1. By the Act of Parties :— Termination of Agency by the Act of Parties takes place in the following ways:

a) *By Agreement :—* Agency may be terminated at any time by a mutual agreement between the principal and agent.

b) *Revocation by Principal :—* The principal may revoke the agency at any time by giving notice to the agent. Section 203 says, when principal may revoke agent's authority. It reads as follows -

"The principal may, save as is otherwise provided by the last preceding section, revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal."

c) *Renunciation by Agent :—* Renunciation means "withdrawing from responsibility as agent". As the principal can revoke the agent's authority, so also the agents can renounce the agency. The agent must give to his principal reasonable notice of renunciation, otherwise he will be liable to make good for the damage caused to the principal for want of such notice(sec. 206). Like revocation, renunciation may also be express or implied (Sec. 207). Where the agency is for a particular time, premature renunciation, without sufficient cause, will make the agent liable to his principal (Sec. 205).

2. **By Operation of Law :—** Termination of Agency by Operation of Law takes place in the following cases:

a) *By Completion of Agency :—* Agency comes to an end after the completion of the work for which the agency is created.

b) *By Expiry of time :—* If the agency is created for a particular time, it is terminated after the expiry of the time.

c) *Death or Insanity of Principal or Agent :—* Section 209 imposes on agent, duty to terminate the contract of agency on the death of the principal. In other words, agency comes to an end on the death or insanity of the principal or agent. Section 209 reads as follows -

"When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him."

d) *Insolvency (Bankruptcy) :—* If the principal becomes an insolvent, agency comes to an end (S.201). An insolvent or bankrupt is a person, who is unable to run the business due to excess of liabilities over assets.

e) *Dissolution of Company or Firm:—* A Company or Firm may be regarded as a principal in the contract of agency. If the Company or Firm is dissolved, the agency comes to an end.

f) *Destruction of the subject matter :—* If the subject matter of the agency is destroyed, agency comes to an end.

Example : An agency is created for sale of a house. If the house caught fire before the sale, the agency comes to an end. (In this contract, house is the subject matter).

g) *Principal becoming an alien enemy :—* An Agency may be created between the Principal and Agent belonging to two countries during peace time. Later, war broke-out between the two countries. Then, the principal becomes an alien enemy and hence, the contract of agency comes to an end.

Case Comment (Part-C)

Problem :— Murty directs Narayana to sell his estate. Narayana finds a mine in the estate. Murty is unaware of it, Narayana informed Murty that he wishes to buy the estate for himself. Murty allowed Narayana to buy the estate. Murty on discovery came to know that Narayana is aware of the mine. Murty approached you. Kindly advise how to avoid that sale. (A.U./Sept./Oct. 1999, Part-C, Q.No.2, Marks:20)

Ans: Instant problem relates to duties of an agent to his principal in a contract of Agency as provided for under Sections 211 to 221 of the Indian Contract Act, 1872.

It attracts the principles enshrined in:

i) Section 215 of the Indian Contract Act, 1872, which imposes on Agent, "duty not to deal on his own account and make secret profit; and

ii) Section 216 of the Act, which confers on the principal, "right to claim/recover from the agent any such benefit or repudiate the contract.

The Relevant decided case is :

De Bussche vs. ALT (1878) 8 Ch. D. 286 :

Issued Involved :— The questions involved in the problem are :

1. Whether Narayana, the agent in the instant problem, who was directed to sell the estate can buy it for himself by dealing on his own account?

2. Whether Murty, the principal, has a right to recover/claim the benefit by repudiating the contract?

With regard to the first question, Narayana, in the instant case can not buy the estate for himself as laid down in section 215 of the Indian Contract Act, 1872, which reads as follows:

Section 215:— Section 215 of the Indian Contract Act, 1872, imposes on Agent, "duty, not to deal on his own account in the business of agency without the consent of the principal."

Section 215 reads as follows:

"If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances, which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows either that any material fact has been dishonestly concealed from him by the agent or the dealings of the agent have been disadvantageous to him" (Sec.215).

Thus, Section 215 envisages that, it is the duty of the agent not to deal on his own account and conceal/supress material facts to make any secret profits. Therefore, Narayana, the agent in the instant problem cannot buy the estate for himself.

Regarding the second question, whether Murty, the principal has a right to claim the benefit by repudiating the contract, Section 216 answers in affirmative. Section 216, confers on principal, "right to benefit gained by agent dealing on his own account in business of agency". It reads as follows:

Section 216: "If an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit, which may have resulted to him from the transaction".

Thus, Section 216 makes it clear that, the principal has a right to claim from the agent any benefit, which may have resulted to him from the transaction or repudiate the transaction by showing/ establishing:

i) that any material fact has been dishonestly concealed from him by the agent; or

ii) that the dealings of the agent have been disadvantageous to him.

Therefore, Murty the principal in the instant case may either repudiate or adopt the sale of the estate at his option. In other words, Murty is entitled to get back the estate from Narayana by returning the price or can claim any benefit, which may have resulted to Narayana as a result of the transaction.

Illustrations and Case Law:— The Illustrations and relevant decided case detailed below, further explain the above answers (i.e. Narayana cannot buy the estate for himself and Murty can claim the benefit by repudiating the contract).

Illustration on Sec.215:— The facts of this illustration given under Sec.215 of the I.C. Act are identical to the given problem.

'A' directs 'B' to sell 'A's estate. 'B' on looking over the estate before selling it, finds a mine on the estate, which is unknown to 'A'. 'B' informs 'A' that he wishes to buy the estate for himself, but conceals the discovery of the mine. 'A' allows 'B' to buy, in ignorance of the existence of the mine. 'A', on discovering that 'B' knew of the mine at the time he bought the estate may repudiate or avoid the sale at his option.

Illustration on Sec.216:— 'A' directs 'B', his agent, to buy a certain house for him. 'B' tells 'A' it cannot be bought and buys the house for himself. 'A' may on discovering that 'B' has bought the house, compel him to sell it to 'A' at the price he gave for it.

Relevant Case Law : *De Bussche vs. ALT* (1878) Ch.D.286

Facts of the Case :— The plaintiff consigned a ship to G & Co. in China and directed them to sell it for not less than 90 thousand dollars. G & Co. with the consent of the plaintiff employed the defendant ALT in Japan to sell the ship. As there was no customer to purchase the ship, the defendant purchased the ship for

himself at the stated price (90 thousand dollars) without the consent of the plaintiff. Later, the defendant sold the ship to a Japanese prince for 160 thousand dollars. When the plaintiff came to know about the re-sale, sued the defendant (Alt) to account for the profit made out of re-sale.

The defendant pleaded that, there was no agency between him and the plaintiff and hence, he could not be made liable.

Decision/Judgment:— The Court held that the defendant was the plaintiff's substituted agent, who was directly answerable and accountable to the principal (plaintiff) like an Agent and is liable to account for the profits.

In view of the above, we may advise Murty, the principal in the instant problem to evade the sale and get back the estate by returning the price or adopt the sale by claiming the profit earned as a result of the transaction.

Questions and How to Answer

Q) Define Agency of necessity? (A.U. Model Q.P. Part-A, Q.No.5, Marks 2).

Ans. Write the meaning of Agency in 2 or 3 lines. Write now, about the agency by necessity in brief. The contract of agency may be created under different modes. 'Agency by necessity' is one among them.

Q) Define the agency by holding-out? (N.U. April, 1999, Part-A, Q.No.6, Marks 2).

Ans. Write the meaning of agency in 2 or 3 lines.

'Agency by holding-out' is one of the modes by which the contract of agency is created.

Write now about the agency by holding-out in brief.

Q) Explain the doctrine of 'Agency by estoppel'.

Ans. Write the meaning and definition of agency in 2 or 3 lines. There are different modes by which a contract of agency is created.

One among them is, "the doctrine of agency by estoppel.".

Write now, in brief, about 'agency by estoppel'.

Q) When is the agent personally liable? (N.U. April,1999, Part-A, Q.No.7, Marks 2).

(P.S:— It is an essay question, but asked as short question - The student has to concise the answer).

Ans. Write in brief about the personal liability of an Agent.

Q) Define Agency and explain various modes for creation of Agency?

Ans. Write meaning, definition and modes of agency.

Q) Discuss the position of agent in a contract of agency and his capacity to bind by the principal?

Ans. This question refers to rights and duties of Agent in a contract of agency (write meaning, definition of agency first and then rights and duties of agent).

Q) 'Delegatus non-potest delegare' - Discuss with exceptions?

Ans. The maxim 'Delegatus non potest delegare' refers to delegation of authority by an agent or appointment of sub-agent by an agent in a contract of agency.

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Lecture - V

CONTRACT OF SALE OF GOODS
(The Indian Sale of Goods Act, 1930)

In a civilised society, transfer of property from one person to another is quite obvious. When a movable property is transferred from one living person to another living person (i.e. transfer inter vivos), the law applied is the Sale of Goods Act, 1930. In other words, the disputes relating to transfer of movable property between two living persons are governed/settled by the Sale of Goods Act, 1930. Before passing of the Act, the provisions relating to sale of goods were enshrined in Chapter-VII, containing Sections 76 to 123 of the Indian Contract Act, 1872. The Sale of Goods Act was passed by replacing/repealing Sections 73 to 123 of the Indian Contract Act, 1872. (The Transfer of Property Act, 1882 deals mainly with transfer of immovable property and also movable property between two living persons i.e. transfer inter vivos and the Succession Act deals with the transfer of property from the dead persons to the living person/persons).

The Act (The Sale of Goods Act, 1930) is a piecemeal legislation containing 66 sections divided into VII chapters. Chapter I comprising sections 1 to 3 contains preliminary aspects viz. Short title, Definitions and Application of the Act. Chapter II containing sections 4 to 17 deals with the provisions relating to the formation of the contract of sale. Chapter III containing sections 18 to 30 deals with effects of the contracts with regard to transfer of property as between seller and buyer. Chapter IV containing sections 31 to 44 lays down the provisions relating to performance of the contract. Chapter V containing sections 45 to 54 deals with rights of the unpaid seller against the goods. Chapter VI containing sections 55 to 61 makes provision for suits for breach of the contract. Finally chapter VII comprising of sections 62 to 66 contains miscellaneous provisions.

The Act came into force on 1st July 1930. It applies/extends to the whole of India except the State of Jammu and Kashmir.

This Lecture covers:

1. Definitions (Section 2)
   - i) Buyer (Sec. 2(1)
   - ii) Delivery (Sec.2(2)
   - iii) Document of title to goods (Sec. 2(4)
   - iv) Future Goods (Sec. 2(6)
   - v) Goods (Sec. 2(7)
   - vi) Mercantile Agent (Sec. 2(9)
   - vii) Price (Sec. 2(10)
   - viii) Property (Sec.2(11)
   - ix) Quality of Goods (Sec. 2(12)
   - x) Seller (Sec. 2(13)
   - xi) Specific Goods (Sec. 2(14)
2. Contract of Sale.
3. Sale & Agreement to Sell.
4. Distinction between Sale and Agreement to Sell.
5. Quasi Contract and Quasi Contract of Sale.
6. Goods : Meaning, Definition and Kinds
7. Conditions and Warranties.
8. Implied Conditions and Warranties.
9. Caveat Emptor.
10. Right of Unpaid Vendor/Seller (Vendor's Lien);
11. Nemo dot quod non habet; and
12. Passing of Risk.

1. Definitions

Section 2 of the Sale of Goods Act, 1930 provides for some definitions as stated below:

i) Buyer (Sec. 2(1) : According to Sec. 2(1) of the Act, buyer means a person who buys or agrees to buy goods.

ii)Delivery (Sec.2(2) : According to Sec.2(2) of the Act, 'Delivery' means voluntary transfer of possession from one person to another.

iii) Document of title to goods (Sec. 2(4): According to Sec. 2(4) of the Act, 'document of title to goods' includes a bill of lading, dock-warrant, warehouse-keeper's certificate, wharfinger's certificate, railway receipt, multimodel transport document warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.

A document of title to goods is one used in the ordinary course of business and treated as one conferring a right to possession or authorising by endorsement on it or by mere delivery, the possessor of it to receive goods mentioned in such document. The document thus symbolises the goods. its purchaser may either himself receive the goods or transfer such right to some one else by delivering the document or by making a suitable endorsement on it. Instances of documents of title to goods are as follows :

(a) Bill of Lading : This is a receipt for goods shipped aboard a ship named in the bill and signed by the Captain of the ship or his representative.

J.V.Gokal & Co.(P) Ltd. v. Asst. Collector, Sales Tax, A.I.R. 1960 SC 595 : In this case, it has been pointed out that 'a bill of lading is a writing signed on behalf of the owner of the ship in

which the goods are embarked, acknowledging the receipt of the goods and undertaking to deliver them at the end of the voyage subject to such conditions as may be mentioned in the bill of lading'. It is well settled that a bill of lading represents the goods, and the transfer of it operates as Transfer of Goods.

(b) Dock Warrant : It is a document authorising the person presenting it to receive possession of goods. It is issued by a Dock owner and specifies the goods which are to be delivered.

(c) Railway Receipt : Railway receipt is a document of title, as per the definition of the term in Sec. 2(4), Sale of Goods Act, and enables the person mentioned as consignee to give a valid discharge in respect of the goods to which it relates. In ***E.D. Kerawalla v. Dominion of India, A.I.R. 1955 Mad.70***, it was held that a consignee of goods or an endorsee of a railway receipt though he be an agent of the consignor has sufficient interest in the goods to file a suit against the railway.

iv) Future Goods (Sec. 2(6) : According to Sec. 2(6) of the Act, 'future goods' means goods to be manufactured or produced or acquired by the seller after the making of the contract of sale. Future goods are those, which are not in existence at the time when the contract for sale of goods is entered into. They are to be manufactured or produced after the date of the contract. "Goods", would include stocks and shares under the Indian Law but not under the English Law.

A contract to sell and deliver the crop raised with seed to be sown, or to sell oil not yet pressed, relates to one of future goods.

Future goods should be distinguished from unascertained goods. Unascertained goods are existing but not identified and agreed upon at the time of sale. A may promise to sell 50 bags of rice out of the 500 bags in his godown. This is a sale of unascertained goods. If, however, he promises to sell paddy, which he intends to grow upon his field, it is a sale of future goods. Even future goods may be sold.

v) Goods (Sec. 2(7) : Section 2(7) of the Sale of Goods Act, 1930 says that 'Goods' means every kind of moveable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale.

An actionable claim is a claim realisable by action in a court of law. Thus if A enters into a contract with B, the contractual claim is an actionable claim. After breach is committed, it is only a mere right to sue. A mere right to sue is not transferable. An actionable claim is transferable. An insurance policy gives rise to an actionable claim. Movable property can be transferred by delivery. An actionable claim can be transferred only by means of a written instrument signed by the transferor.

The scope of the definition of the word "goods" under the Indian Sale of Goods Act is wider than that under the English Act. The English Act does not expressly include 'Stock and Shares' and accordingly they would not be goods under the English Act. In ***A.M.P. Arunachalam v. A.R. Krishna Murthy*, 1979 (49) Comp. Cases 662 at Pl 670 (Mad.)** it was pointed out that exhaustive definition of 'goods' in the Indian Act makes it clear that even 'Stock and Shares' can be treated as goods and dealt with as such.

Things attached to the land are called fixtures. Ceiling fans in a house are fixtures. If they are agreed to be severed from the land before sale, they can be treated as movable property. Growing crops and grass are movable property. In short, whatever is not immovable property is movable property. "Goods" is the residual category after excluding actionable claims and money from movable property.

Commissioner of Income Tax v. Bhurangya Coal Co. A.I.R. 1959 SC 254 :

In this case, it was pointed out that "fixtures could be held to be movable goods, in Sec. 2(7) of the Act, only if such things were intended to be severed and sold separately". It was accordingly observed in ***Mahadeo v. State of Bombay, AIR 1959 Sc 735***, that "contracts conveying rights to take forest produce mainly Tendu leaves, Timber, Bamboos etc., the soil for making bricks, the right to prune, coppice and burn Tendu trees, and right to build on and occupy land for purpose of business, with proprietors of estates, cannot be said to be contracts of sale of goods simpliciter".

vi) Mercantile Agent (Sec. 2(9) : According to section 2(9) of the Act, 'mercantile agent' means a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods.

An agent is a person who brings about contractual relations between his principal and third parties. If customarily in the course of his business he has authority to sell the goods of the principal or consign them for sale or to buy goods for the principal or to raise money on the security of such goods he is called a mercantile agent.

An ordinary agent who has no authority to sell cannot give a good title to the buyer. But a mercantile agent in possession of goods with the consent of the principal (owner) can convey a good title to a bona fide purchaser when he sells such goods in the ordinary course of his business.

Oppenheimer v. Attenborough, 77 LJKB 209 (CA) :

In this case, it was held by Lord Alverstone, C.J. as "When you are dealing with a person who is a mercantile agent, you have to find whether in the customary course of his business as such agent he has authority to sell etc., when you are dealing with an

agent in possession of goods, 'you have no doubt to consider what kind of agent he is, and what his customary course of business would be when he is acting in the capacity of agent, having got the class of mercantile agent we come to Sec. 2(1), which deals with the circumstances under which the transaction must be carried out. I think the words, acting in the ordinary course of business of a 'Mercantile Agent' mean that the person must act as if he were carrying out a transaction which he was authorised to carry out."

Lowther v. Harris, 1927 (1) KB 393 :

In this case, the plaintiff made arrangement for disposal of some furniture and tapestry belonging to him through P acting as his agent. P, who obtained possession of some of the articles by fraud sold them to defendant and absconded with the amount. The question arose whether 'P' was 'Mercantile Agent'. Answering the question in the affirmative it was observed: "In my opinion P, who had his own shops and who received and took cheques in his own registered business name and earned commissions, was not a mere servant but an agent even though his discretionary authority was limited".

vii) Price (Sec. 2(10) : According to Sec.2(10) of the Sale of Goods Act, 1930, 'price' means the money consideration for a sale of goods.

viii) Property (Sec.2(11) : According to Sec. 2(11) of the Act, "property" means the general property in goods, and not merely a special property.

ix) Quality of Goods (Sec. 2(12) : Section 2(12) of the Sale of Goods Act, 1930 states that quality of goods include their state or condition also.

x) Seller (Sec. 2(13) : According to Section 2(13) of the Act, "seller" means a person who sells or agrees to sell goods.

xi) Specific Goods (Sec. 2(14) : According to the Act, "Specific Goods" means goods identified and agreed upon at the time a contract of sale is made.

2. Contract of Sale (Meaning and Definition)

Meaning : The expression 'Contract of Sale', literally means "a contract where one person transfers absolute interest in the subject matter (movable property/goods) to another in lawful consideration for price paid or promised., partly paid and partly promised. The transferor is called the Seller or Vendor., the transferee is called the Buyer or Purchaser or Vendee., and the consideration is called "price"

Definition : Section 4(1) of the Sale of Goods Act, 1930 defines "Contract of Sale of Goods, as a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price".

The person who sells or agrees to sell is called 'Seller' or 'Vendor' (Sec.2(13). The person who buys or agrees to buy is called 'Buyer' or 'Purchaser' (Sec.2(1). The contract between the Seller and Buyer is called 'the contract of sale'.

The contract of sale (as stated above) includes both Sale and Agreement to sell.

Essential Elements : To constitute a contract of sale, the following ingredients are to be satisfied -

i) There must be atleast two parties.

ii) There must be an agreement between the two parties.

iii) The subject matter of the contract must be "goods".

iv) There must be a transfer of subject matter (goods) from seller to the buyer.

v) There must be a lawful consideration known as 'price'.

i) Two Parties : To constitute sale, there must be atleast two parties - a seller and a buyer and they must be different persons for a person cannot buy his own goods.

ii) Agreement : To constitute a transaction of sale there should be an agreement express or implied, relating to goods to be completed by passing of title in those goods. There must be an agreement between the parties for the sale of the very goods in which eventually property passes.

iii) Goods : The subject matter of the contract of sale must always be goods. The word "goods" has been defined in section 2(7) of the Sale of Goods Act, 1930. According to it 'goods' means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract for sale.

iv) Transfer : One of the most essential elements of a contract of sale is the transfer of the property in goods to the buyer. Indeed, it is the essence of a contract of sale. But a transfer of property in goods has to be distinguished from "a mere transfer of goods by the owner from one place to another" which does not amount to sale.

When a customer goes to a restaurant and orders food and in respect of which he pays the price indicated therein and the said food items are supplied to him, it would clearly be a case of transfer of property in the goods to the customer. Whether the customer eats the entire or part of the dish or chooses not to eat at all would make no difference if he pays for the dishes supplied. The moment the dish is supplied and sale price paid, it would amount to a sale.

v) Price : Yet another essential element of a contract of sale is price i.e. consideration in terms of money. Since an agreement without consideration is void by virtue of Section 25 of Indian Contract Act, 1872, a contract of sale also will not be complete without some consideration. In case of a contract of sale, the

consideration must be some price, i.e., consideration in terms of money. It is this special feature which distinguishes a contract of sale from a barter or exchange. What is required is that there must be some consideration in money. Therefore, where goods are exchanged partly for goods and partly for money, or for exchange of goods or alternatively the price, it will still constitute a contract of sale.

3. Sale and Agreement to Sell

Sale : Meaning : If the property in goods is immediately transferred from seller to buyer, it is called 'Sale'.

Eg.:— 'A' sold 10 bags of rice to 'B' against the payment of Rs. 5,000/-

Sale : Definition : Sale may be defined as "transfer of ownership in the goods by the seller to the buyer in exchange of price paid or promised or partly paid and partly promised".

Agreement to Sell :Meaning : If the transfer of property in goods is to take place in future (from seller to buyer), it is called "agreement to sell".

Eg:— 'A' agrees to sell 10 bags of rice to 'B' for Rs. 5,000/- after getting the stock.

Agreement to Sell :Definition : "It is a contract, whereby the seller agrees with the buyer to transfer the title of ownership on a future date upon satisfying certain conditions".

Section 4 of the Sale of Goods Act, 1930 defines Sale and Agreement to Sell as :

1. A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract of sale between one part-owner and another.
2. A contract of sale may be absolute or conditional.

3. Where under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place in future or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

4. An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

4. Distinction between Sale and Agreement to Sell

Following are main differences between Sale and Agreement to Sell.

Sale	Agreement to Sell
1. Property in goods transfers from Seller to Buyer immediately.	1. Property in goods does not transfer immediately.
2. It is an executed contract	2. It is an executory contract.
3. It creates right in rem.	3. It creates rights in personam.
4. The seller can sue the buyer for breach of the contract.	4. The seller can sue the buyer only for damages but not for the price.
5. Sale is liable for the Sales Tax.	5. Agreement to sell is not liable for the Sales Tax.
6. Seller has no right of resale.	6. Seller has a right of resale
7. If the goods are destroyed, the loss is borne by the buyer eventhough the goods are in the possession of the seller.	7. The loss falls on the seller eventhough the goods are in the possession of the buyer.

5. Quasi Contract and Quasi Contract of Sale

Quasi Contract : Meaning :

The term *'Quasi'* is a Latin word, which means "as if" or "Similarly". It means seemingly, apparently, but not really. The expression 'quasi contract' is derived from the Roman Law "*Obligatio quasi ex contractu*". Quasi contract is not a real contract entered into by parties intentionally. *It resembles a contract, in which law imposes an obligation on a person to perform an obligation on the ground of equity.*

Underlying Principles: *Quasi* contract is based on the principle of equity that "*A person shall not be allowed to enrich himself unjustly at the expense of another*". In other words, a person should not receive or accept any benefit unjustly. If so, he has an obligation to give it back to the right owner. Such obligation is called *Quasi*-contractual obligation.

Eg. 'A' leaves his handbag at 'B's house by mistake. 'B' has *quasi*-contractual obligation to return it to 'A'.

As stated above, an obligation is not created in *quasi* contract by entering into an agreement. The law creates such obligation on the ground of Natural Justice.

It is to be noted that, in a contract, obligations are created on the parties out of an agreement, whereas in a *quasi* contract, obligations are created on the parties *without* any agreement.

Quasi Contract :Definition: Dr. Jenks defined *'Quasi* Contract', as "a situation, in which law imposes on one person on the ground of natural justice, an obligation similar to that, which arises from a true contract although no contract, express or implied has in fact been entered into by them".

Quasi Contract of Sale : Property in goods gets transferred in two ways namely -

i) By the act of parties and

ii) The operation of law.

The provisions contained in the Sale of Goods Act deal with transfer of property in the goods mentioned above in the first category, namely, by an act of the parties. The nomenclature 'Quasi Contract of Sale' is given to transfers of property in goods effected as a result of operation of law.

Hart v. Mills, 15 M & W 85 : In this case, it was held that if there is no contract, or there is only a contract for sale of a certain quantity but the seller sends the goods of a larger quantity than contracted for, and the person in the position of buyer retains the goods, in such cases a new contract is implied, that the purchaser will pay for the value of the goods retained by him.

It would thus be seen that sometimes the law attaches to a transaction consequences similar to those arising out of a sale and such a transaction is called a quasi-contract of sale. Chalmers points out that in England a satisfied judgement in an action of detenue operates as a sale and is treated as a quasi-contract of sale.

Cooper v. Shepherd, 1846 (3) CB 226 : In this case, it has been pointed out : " Where goods have been wrongfully taken, converted, or detained, and the owner has a judgement recovered by the plaintiff for damages on the footing of the full value of the goods and satisfied, either voluntarily by the defendant or by execution, operates as a sale of the goods by the plaintiff to the defendant as from the time when the judgement is satisfied".

6. Goods : Meaning, Definition and Kinds

Goods :Meaning : The expression 'goods' means "every kind of movable property other than actionable claims and money". The Sale of Goods Act, 1930 deals with the Sale/transfer of movable property from one person to another.

Goods :Definition : According to Section 2(7) of the Sale of Goods Act "goods" means every kind of moveable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale".

As stated above, the term "goods" does not include actionable claims and money. An actionable claim is an act or claim for which an action can be instituted in civil court for realisation of the benefit. *Eg.*:— Claim under Insurance Policy.

Kinds of Goods :— Goods may be classified under the following heads namely:

i) Existing Goods
   a) Specific goods ; and
   b) Unascertained goods.

ii) Future Goods; and

iii) Contingent Goods.

i) Existing Goods :— Existing Goods are those, which are owned and possessed by the seller at the time of making of the contract of sale.

Eg: 'A' sells 10 bags of rice, which is lying in his godown. The rice bags are called 'existing goods'.

The existing goods may be sub-divided under the following kinds namely:

a) Specific goods :— Goods identified and agreed upon at the time, a contract of sale is made are called "specific goods"

Eg: 'A' has three refrigerators x,y,z. 'A' offers to sell x, 'B' accepts to purchase it. 'x' is considered to be specific goods.

b) Unascertained goods :— Goods not identified at the time of making of the contract of sale are called 'Unascertained goods'.

Eg: 'A' has 50 bags of sugar in his godown. He offers to sell 10 bags to 'B' without specifying which of them to be delivered. 'B' accepts to purchase. It is a sale of unascertained goods.

ii) Future Goods :— Future goods are those, which are to be manufactured or produced or acquired by the seller after making of the contract of sale (Sec.2(6). A contract for the sale of future goods is not a sale, but is an agreement to sell.

Eg: 'A' agrees to sell 'B' the grass to be grown on his land next month.

iii) Contingent Goods :— It is a type of future goods. It means "goods, the acquisition of which by the seller depends upon a contingency of happening or non-happening of an event.

Eg: 'A' agrees to sell a land to 'B' if he wins the case in the court (of law by a decree in his favour). 'A's title is subject to the contingency of winning and hence the land is called 'Contingent Goods'.

7. Conditions and Warranties

Sections 11 to 13 under Chapter II of the Sale of Goods Act, 1930 lay down the provisions relating to conditions and warranties or express conditions and warranties.

Section 11 deals with "stipulation as to time". It runs as follows -

"Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be of the essence of a contract of sale. Whether any other stipulation as to time is the essence of the contract or not depends on the terms of the contract."

Section 12 deals with condition and warranty. It reads as follows -

"(1) A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.

(2) A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated.

(3) A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated.

(4) Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.

Section 13 makes provision as to when condition has to be treated as warranty. It reads as under -

(1) Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated.

(2) Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect.

(3) Nothing in this section shall affect the case of any condition or warranty fulfilment of which is excused by law by reason of impossibility or otherwise.

In a contract of sale of goods, the seller makes certain statements or representations ensuring specific and proper performance of the Contract. Such representations may be either in form of conditions or warranties. Whether the stipulation is a condition or warranty depends upon the circumstances of the case.

Eg.: 'A' promises to supply wedding cards to 'B', 5 days before his marriage on 20th June. 'A's duty to supply wedding cards on or before 15th June is a condition. If 'A' fails to supply on or before 15th June, but after 20th, it amounts to a breach of condition and hence, 'B' can repudiate (avoid) the contract. Instead of wedding cards, if 'B' places an order with 'A' for supply of visiting cards and 'A' fails to supply them in time, it amounts to breach of warranty.

A stipulation in a contract of sale of goods may be either condition of a warranty (Section 12(1). Strict compliance to condition is essential, while strict compliance to warranty is not so essential but necessary. In other words, condition is essential while warranty is necessary for formation of the contract.

Definition of Condition (Section 12(2) :— According to Section 12(2) of the Sale of Goods Act, 1930, "a condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated".

In the above example, promise to supply wedding cards on or before 15th June (for circulation before the date of marriage, the 20th June) is a condition. If 'A' supplied the wedding cards on or after 20th, there is no use as it amounts to breach of condition and hence, 'B' can avoid the contract.

Definition of Warranty (Section 12(3) :— Section 12(3) of the Sale of Goods Act, 1930 defines - "A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated."

In the above example, if 'A' supplies visiting cards on 20th June, 'B' cannot refuse, since they can be used even after 20th. However, 'B' can claim damages (for delay and incidental loss thereto) as it amounts to breach of warranty.

The conditions and warranties may be express or implied. When the *conditions and warranties are definitely stated* in the contract, *they are called express conditions and warranties.* They protect (safeguard) the interests of the buyer from the principle of 'Caveat Emptor', which is a privilege or defence to the seller. (Caveat Emptor, is explained in detail after Implied Conditions and Warranties in this lecture). Implied conditions and warranties are those, which the law incorporates into the contract unless the parties agree to the contrary.

Therefore, it was laid down in *A Thomas vs. A. Mani,* AIR 1960 Ker. 176 that "a condition is a more vital undertaking than warranty and the consequences that follow from its breach are different."

In ***Arcot vs. Ronaasen & Son*** **(1939) 1 AER 92** : The plaintiff in the instant case, placed an order with the defendant, a timber dealer to supply timber sizes cut in 1/2". But the defendant supplied the timber sizes varying from 1/2" to 2/3". In an action against the defendant the plaintiff was allowed to repudiate the contract on the ground that the defendant's act amounted to the breach of condition.

Distinction between Conditions and Warranties :— Sections 11 and 12 of the Sale of Goods Act deal with conditions and warranties.

Following are the notable points of distinction between the Conditions and Warranties

Condition	Warranty
1. It is a stipulation, essential to main purpose of the contract.	1. It is a stipulation, collateral to the main purpose of the contract.
2. Breach of condition gives rise to repudiate the contract.	2. Breach of warranty does not give rise to repudiate the contract, but gives rise to claim damages
3. In certain cases, breach of condition may be treated as breach of warranty.	3. A breach of warranty cannot be treated as breach of condition.

When condition to be treated as warranty (Section 13):— A condition may be treated as a warranty under the following circumstances:

1. Voluntary waiver :— A contract of sale may be subject to a condition to be fulfilled by the seller. The buyer may waive the condition voluntarily, or he may treat the breach of such condition as a breach of warranty (Section 13(1).

2. Contract severable :— If the contract of sale is severable, the buyer may accept the goods or any part thereof, the breach of condition by seller may be treated as breach of warranty (unless there is an agreement to the contrary Section 13(2).

3. Difference as to treatment :— Where the aggrieved party is contended with the damages, the breach of condition may be treated as the breach of warranty.

As stated above, a breach of condition may be treated as a breach of warranty. However, a breach of warranty cannot be treated as a breach of condition.

Effect or consequences of a breach of condition or warranty : Since a condition is a stipulation essential to the main purpose of the contract its breach by one party entitles the other to treat contract as repudiated. For example, if the seller makes a breach of condition, the buyer may reject the goods. Similarly, if the breach is made by the buyer, the seller may treat it as a breach of contract and not perform his own part of the obligation. Thus, if a lady orders a red saree asking the seller to deliver it by 15th January so that she can wear it on 16th on the occassion of her wedding but the seller supplies a black saree instead of a red one or supplies the saree on 18th January, there is a breach of condition, the lady buyer can treat the contract as repudiated, she can reject the goods and sue the seller for improper performance.

As discussed above, a warranty is a stipulation collateral to the main purpose of the contract, its breach is not considered to be serious. The breach of a warranty by one party entitles the other only to claim damages rather than avoiding the contract. Thus, for example, the buyer agrees to pay the price in advance by 15th December and the goods are to be delivered on 15th January, but the buyer makes payment late, say on 25th December, the seller's remedy in such a case is to claim compensation, because, according to Sec. 11, the time of payment of price is generally deemed to be a warranty.

8. Implied Conditions and Warranties

Sections 14 to 17 under Chapter II of the Sale of Goods Act, 1930 lay down the provisions relating to "Implied Conditions and Warranties".

Section 14 deals with Implied Undertaking as to **Title.**

Section 15 deals with **Sale by Description.**

Section 16 speaks about **Caveat Emptor** and

Section 17 deals with Sale by **Sample.**

As stated above, conditions and warranties may be express or implied. If they are definitely stated in the contract, they are called 'express conditions and warranties'. If they are inferred from the circumstances of the case, they are called 'implied conditions and warranties'. Sections 14 to 17 of the Sale of Goods Act, 1930 deal with Implied Conditions and Warranties. They safeguard the interests of the buyer from the rule 'Caveat Emptor', which is a privilege to the seller.

Implied Conditions (Secs. 14 to 17):— Implied Conditions may be explained as follows:

1. Implied undertaking (conditions) as to title (Sec.14);
2. Sale by Description (Sec.15);
3. Implied condition as to Quality or Fitness (Sec.16(1);
4. Implied condition as to Merchantability (Sec.16(2);
5. Implied condition by custom (Sec.16(3);
6. Sale by Sample (Sec.17).

1. As to title (Sec.14) : Section 14 provides for implied undertaking as to title etc. It reads as follows -

"In a contract of sale, unless the circumstances of the contract are such as to show a different intention there is -

(a) an implied condition on the part of the seller that, in the case of a sale, he has a right to sell the goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass;

(b) an implied warranty that the buyer shall have and enjoy quiet possession of the goods;

(c) an implied warranty that the goods shall be free from any charge encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made.

In a contract of sale, unless the circumstances specifically state/show, there is an implied condition that the seller has a title and has a right to sell the goods.

In an agreement to sell, he will have a right to sell, when the property is to pass. Relevant case on this point is:

***Rowland vs. Divall* (1923) 2 KB 500, CA:(1923)All L.R. Rep. 270** :— In this case, the plaintiff purchased a car from the defendant, who has no title. Later, he was forced to return it to the true owner. The plaintiff sued the defendant and recovered the price, even though he had used the car for four months.

2. As to description (Sec.15) : Section 15 deals with Sale by Description. It reads as follows -

"Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

In a contract of sale, there is an implied condition that the goods shall correspond with the description. If the goods sold/ supplied are not according to the description, the buyer can refuse them. If there is a sample the goods must be as per the sample. The expression 'sample' denotes quality, and not the nature of goods. Relevant case on this point is :

***Varley vs. Whipp* (1900) 1 QB 513** : In this case, the plaintiff (buyer) purchased a second hand reaping machine as per the description given by the seller. But, it did not correspond with the description. In an action against the defendant, the plaintiff was held entitled to reject the machine.

Moore & Co. v. Landauer & Co. (1921) 2 KB 529 CA : In this case, the buyer in London ordered for 3000 tins of canned fruit from Australia, to be packed in cases with each case containing 30 tins. The seller sent the tins of canned fruit packed in cases with

each case containing 24 tins. The court held that the buyer had a right to reject it.

Andrew Brothers Ltd. v. Singer & Co. Ltd. (1934) 1 KB 17 : In this case, the buyer approached the seller for a "new Singer car". A contract for sale of car was concluded between them, and in that contract, "the seller was excluded all conditions and warranties implied by statute, common law or otherwise". The car supplied by the seller was not a "new Singer car", and it did not correspond with the description. The Court held that it was a clear implied condition, and breach of which entitled the buyer to reject the car.

3. As to Quality or Fitness (Sec.16(1) : Section 16 speaks about "implied condition as to quality or fitness". It reads as follows-

Subject to the provisions of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows :

(a) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgement, and the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be reasonably fit for such purpose:

Provided that, in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose.

(b) Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality.

(c) An implied warranty on condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

(d) An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith.

In a contract of sale, there is no implied condition as to quality and fitness. However, if the buyer purchases for a specific purpose and expressly or impliedly leaves the matter to seller's skill to supply suitable or appropriate goods (for the purpose) there is an implied condition.

Priest vs. Last **(1903) 2 KB 148** :— In this case, the plaintiff purchased a hot water bottle for a particular purpose and left the matter to defendant's choice to suggest/supply suitable one. But the hot water bottle supplied by the defendant was burst and injured the plaintiff's wife. In an action by the plaintiff, the defendant was held liable.

4. As to Mercantability (Sec.16(2) :— The expression 'Merchantability' is not defined in the Act, but denotes the condition and quality of a product, which a reasonable and prudent man, after examination would normally accept. 'Merchantable quality' means goods of any kind are of merchantable quality if they are as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect, having regard to any description applied to them, the price(if relevant) and all the other relevant circumstances.

To constitute merchantable quality, the following two conditions are to be satisfied.

a) the goods should have been bought by description; and

b) from the seller who deals in goods of the description.

There is an implied condition, where the goods are sold by description.

Grant vs. A.K.Mills Ltd. 1936 AC 85 : In this case, the plaintiff purchased an underwear from the defendant. After wearing, he got a skin disease. In an action by the plaintiff, the defendant was held liable.

Jones v. Just (1868 LR 3 QB 197) :In this case, the plaintiff-buyer ordered for Manila hemp from defendant (Singapore). While the bales of Manila hemp were transported from Singapore, the entire stock was wetted with sea water and spoiled. It was so damaged that it was sold in the market at 5% of its original value. The buyer sued for recovery of damages. The Court held that the buyer was entitled to recover the difference between what it fetched on being re-sold with all faults and what it would have been worth if it had been shipped in proper condition.

5. Implied Condition by Custom (Sec.16(3) :— An implied condition as to quality for fitness may be annexed by the custom or usage of trade. The provisions of the contract shall not be contrary to the custom or usage.

6. Sale by sample (Sec.17):— Section 17 deals with Sale by Sample. It reads as follows -

"(1) A contract of sale is a contract for sale by sample where there is a term in the contract express or implied, to that effect.

(2) In the case of contract for sale by sample there is an implied condition,-

(a) That the bulk shall correspond with the sample in quality;

(b) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(c) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.

The expression sale denotes 'quality of the product'. Having satisfied with the sample, the buyer places bulk order with the seller. In a contract of sale by sample, there is an implied condition:

1. that the goods shall correspond with the sample;
2. that the buyer is given a reasonable opportunity to compare the bulk with the sample; and
3. the goods must be free from defects.

Implied Warranties :— Implied warranties in a contract of sale may be explained as follows:

1. Implied warranty as a quiet possession (Sec.14(b);
2. Implied warranty as to free from encumbrances (Sec.14(c);
3. Implied warranty as to quality or fitness by usage of trade (Sec.16(4).

1. Quiet Possession (Sec.14(b) :— In a contract of sale, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. In case, such possession is disturbed (due to seller's defective title or other reason) the buyer can claim damages from the seller.

Niblett v. Confectioners' Materials Co., (1949) 2 KB 545 :(1949) 2 All. E.R. 134 : In this case, the sellers had consigned tins of condensed milk bearing the labels "nissly Brand" which was the trade mark of one "Nestle Co." Since the sellers had no right to sell the goods with such labels, the buyers were not allowed to have the possession of the goods unless the labels had been removed. The buyers, having received the goods without labels, suffered loss as the same had to be sold for a lower price. It was held that there was not only a breach of the condition that the seller has a right to sell the goods, there was also a breach of implied warranty of quite possession and, therefore, the sellers were bound to compensate the buyers.

Mason v. Burningham, (1921) 3 K.B. 387 : In this case, the plaintiff purchased a second hand typewriter for 20 Pounds from the defendant. She thereafter spent a sum of 11 Pounds and 10 Shillings for getting it overhauled and putting it in order. Unknown to the parties the typewriter was a stolen one and the plaintiff was compelled to return the same to its owner. In an action by the plaintiff against the defendant, it was held that the defendant had made a breach of warranty implied in a contract of sale of goods that the buyer shall have and enjoy quiet possession of the goods. The plaintiff was entitled to recover not only the sum of 20 Pounds, the price paid for the typewriter, but also the sum of 11 Pounds and 10 Shillings, the amount spent on overhauling, as the same was the loss arising naturally in the usual course of things.

2. Free from Encumbrances (Sec.14(c) :— There is an implied warranty that the goods sold are free from encumbrances. In case, the buyer is forced to clear such encumbrances, he can recover from the seller. In case, the buyer is aware of such encumbrances at the time of the contract, he cannot claim any compensation.

3. Quality or Fitness by usage of Trade (Sec.16(4) :— An implied warranty as to quality or fitness for a particular purpose may be annexed by the usage of trade.

9. Caveat Emptor

The rule/maxim **'Caveat Emptor'** has great significance and good importance in a Contract of Sale. It is a fundamental rule relating to sale in English Common Law. It means 'buyer beware' or 'let the buyer beware'. It is a privilege/defence to the seller and imposes an obligation on the buyer. According to this maxim, the buyer must be very careful while purchasing the goods, and ascertain/ examine whether the goods will serve/suit his purpose. Otherwise, he cannot blame the seller as there is no implied undertaking by the seller that the goods would serve the buyer's purpose.

The rule of **'Caveat Emptor'** is recognised under **Sec.16** of the Sale of Goods Act, 1930, which says **"Subject to the provisions of this Act and any other law for the time being in force, there is no implied warranty or condition as to quality or fitness for a particular purpose of goods supplied under the Contract of Sale".** If the buyer wants protection from this rule, he can do so by inserting in contract, an express condition or warranty.

It is to be noted that, the doctrine of Caveat Emptor is applicable to potent defects and not to the latent defects. Potent defects are those, which are visible and observable. While, the latent defects are those, which cannot be visible/detected without special skill. Eg: If the goods are found in broken condition, it is called potent defect. If the goods appear to be in good condition, but, they lag behind some internal/technical defect, they are called 'latent defects'.

***Re Andrew Yule & Co.,* 59 Cal. 928** : In the instant case, the plaintiff (buyer) ordered a lessain cloth for packing purpose, but did not specify the purpose. Owing to a particular smell, the cloth was not suitable for the packing. Plaintiff's action was failed on the ground of the maxim 'Caveat Emptor'.

In case, the plaintiff (buyer) had specified the purpose of the cloth and reliance is placed on the skill and judgment of the seller, the rule of Caveat Emptor would not apply. Similarly in *Jones vs. Padgett* (1890) 24 QDB 650 — The plaintiff purchased from the defendant indigo cloth for the purpose of making liveries and did not tell the defendant the purpose. Owing to some latent defect, the cloth did not serve the purpose. In an action by the plaintiff the defendant was held not liable under the principle of 'Caveat Emptor'.

Raghava Menon v. Kuttappan Nair, A.I.R. 1962 Kerala 318 : In this case, the plaintiff purchased a wrist watch from the defendant. The watch did not give satisfactory service inspite of the fact that the seller had tried to set it right a number of times. The buyer sued the seller for the replacement of the watch or the refund of the price. It was held that the seller was bound to

replace the watch or, in the alternative, to pay back its price. It was observed that "the plaintiff is a layman and he approaches a fairly reputed firm like the defendant dealing in watches and purchases a watch from them, not for any special purpose, but for the common purpose of knowing the correct time. In such a case, Sec. 16(1) of the Sale of Goods Act must apply, because the buyer makes known to the seller, by implication, the purpose for which he purchases the watch and also relies on the seller's skill or judgement.

Frost v. Aylesbury Dairy Co., (1905) 1 K.B. 608 :In this case, the plaintiff purchased milk from a milk dealer for his family's use. The milk contained typhoid germs, the plaintiff's wife was infected by it and died. Here the purpose for which the milk was to be used was, by implication, made known to the seller. Since the milk was unfit for human consumption, there was a breach of implied condition for which the defendant was held liable.

Gedding v. Marsh, (1920) 1 K.B. 668 : (1920) All E.R. 631 : In this case, the defendant supplied some bottles of mineral water to the plaintiff. The bottles were not the subject-matter of sale as the empty bottles were to be returned after the contents had been consumed. One of the bottles, being defective, burst in the plaintiff's hand and injured her. Although the bottles were not sold and they were not to become the buyer's property, it was held that there was, nevertheless, an implied condition that both the bottles and their contents were reasonably fit for the purpose for which they were required, and the sellers were liable to the plaintiff to compensate her for breach of the implied condition.

Exceptions :— The rule of Caveat Emptor is subject to the exceptions, which are the two implied conditions as given below:

1. Implied condition as to Quality and Fitness (Sec.16(1)
2. Implied condition as to Merchantability (Sec.16(2).

(For details of above two points, refer Implied Conditions).

10. Rights of Unpaid Vendor or Unpaid Seller

Meaning & Definition:— The contract of sale is complete and valid, whether the price is fully paid or promised to be paid, partly paid and partly promised. Unpaid vendor or seller is one, who has not been paid the whole of the price.

According to Section 45(1) of the Sale of Goods Act 1930, "a seller is deemed to be an unpaid seller/vendor:

a) when the whole of the price has not been paid or tendered; or

b) when a negotiable instrument (Cheque, Bill of Exchange etc.) received as a conditional payment has been dishonoured".

Right of Unpaid Seller (Secs. 46 to 61) :— The right of unpaid seller may be explained with reference to the following heads:

A) Rights against the Goods:

1. When property in goods has passed (Section 46(1)
   - i) Right to Lien;
   - ii) Stoppage in transit; and
   - iii) Right to resale.
2. When property in goods has not passed (Section 46(2)
   - i) with-holding of delivery; and
   - ii) stoppage in transit.

B) Rights against the Buyer :

1. Suit for price (Sec.55);
2. Suit for damages (Sec.56);

3. Repudiation of contract (Sec.60); and

4. Suit for interest (Sec.61);

A) Rights against the goods:

1. When the property in goods has passed (Sec.46(1):

i) Right to Lien (Sec.47):— Lien means right to retain till the price is fully paid. An unpaid vendor can exercise lien over the goods sold even though the property in goods has passed to the buyer. The scope of unpaid vendor's lien has been explained in the case of:

Hammonds vs. Barclay (1802) 2 East 235:—It (Vendor's lien) may be defined as a right of retaining property until a debt due to the person retaining it has been satisfied.

Vendor's Lien arises, provided, the following two conditions are satisfied:

1. The buyer has become the owner of the property; and

2. Non-payment of purchase money in whole or in part.

This right of vendor is popularly known as "unpaid vendor's lien". (P.S:— Important for Short Notes).

ii) Stoppage in transit (Sec.50-52):— An unpaid seller/ vendor can extend his right of lien towards the goods in the transit. In other words, an unpaid vendor, who has parted with the possession of the goods, has the right of stopping them in transit, that is to say, he may resume possession of the goods as long as they are in the course of transit and may retain them until payment or tender of price (Sec.50)

iii) Right of resale:— After getting the possession of goods against lien or stoppage in transit, he can exercise the right of resale.

2. When the property in Goods has not passed (Sec.46(2):—

i) *With-holding of Delivery:*— If the property in goods is not passed, he can withhold the goods and can claim damages.

ii) *Stoppage in Transit:*— If the goods are in transit, he can stop and regain the possession of the goods.

B. Rights against the Buyer:— An unpaid seller has the following rights against the buyer:

1. *Suit for Price (Sec.55(2):*— He can sue the buyer for the price and also for damages.

2. *Suit for Damages:*— If the buyer refuses to accept the goods, he can sue for the damages.

3. *Right to repudiate the contract:*— If the buyer fails to perform the contract on or before a particular date (due date) he can avoid (repudiate) the contract.

4. *Suit for Interest :*— Generally, buyer has no obligation to pay interest for the amount of price due. However, an unpaid vendor can claim interest, if there is an agreement to that effect.

11. Nemo Dat Quod Non Habet (Transfer of Title/Sale By Non-Owner)

Sections 27 to 30 under Chapter III of the Sale of Goods Act, 1930 lay down the provisions relating to "Transfer of Title" or "Sale by Non Owner".

Section 27 deals with sale by person not the owner. It reads as follows -

"Subject to the provisions of this Act and of any other law for the time being in force, where goods are sold by a person who is

not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell:

Provided that, where a mercantile agent is, with the consent of the owner, in possession of the goods or for a document of title to the goods, any sale made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the buyer acts in good faith and has not at the time of the contract of sale notice that the seller has no authority to sell."

Section 28 deals with "Sale by Joint Owner". It lays down that, if one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them of such joint owner in good faith and has not at the time of the contract of sale notice that the seller has no authority to sell.

Section 29 deals with "Sale by person in Possession under voidable contract". It lays down that when the seller of goods has obtained possession thereof under a contract voidable under Section 19 or Section 19-A of the Indian Contract Act, 1872, but the contract has not been rescinded at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of the seller's defect of title.

Section 2(i) of the Indian Contract Act, 1872 defines Voidable Contract as an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others.

Section 30(1) which refers to "seller in possession after sale" lays down that where a person having sold goods, continues or is in possession of the goods or of the documents of title to the goods,

the delivery or transfer by that person or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge or other disposition thereof to any person receiving the same in good faith and without notice of the previous sale shall have the same effect as if the person making the delivery or transfer were expressly authorised by the owner of the goods to make the same.

Section 30 (2) refers to "buyer in possession before sale". It lays down that where a person having bought or agreed to buy goods, obtains, with the consent of the seller, possession of the goods or the documents of title to the goods the delivery or transfer by that person or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge or other disposition thereof to any person receiving the same in good faith and without notice of any lien or other right of the original seller in respect of the goods shall have effect as if such lien or right did not exist.

"Nemo dat quod non habet" is a latin maxim, which means "no one can convey (transfer) a better title than what he himself has (possess). In simple words, a person, who is not the owner of the property/goods is not entitled to sell/transfer. This maxim aims to regulate the transfer of defective title and is embodied in Section 27 of the Sale of Goods Act, 1930.

Section 27: According to Sec.27 of the Sale of Goods Act 1930, where goods are sold by a person, who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell. Thus, if the seller's title over the goods is defective, the buyer's title also will be subject to the same defect and hence, the title remains with the true owner and is entitled to take back the goods sold/transferred.

Section 27 envisages that a buyer cannot get a good title to the goods unless he purchases the goods from a person, who is the

owner thereof or who sells them under the authority or with the consent of the owner.

Helby vs. Mathews (1895) AY 471 : The defendant in the instant case was a seller and the plaintiff was a true owner. The defendant obtained certain goods from the plaintiff by paying one instalment on hire-purchase agreement and sold the goods to some third party. In an action by the plaintiff, it was held that, the defendant acquires no title until and unless the last instalment was paid and the sale was invalid.

Exceptions :— The above rule/maxim is subject to certain exceptions as provided for under Sec.27 as follows:

1. Transfer of title by Estoppel (Sec.27)
2. Sale by Mercantile Agent (Sec.27 proviso)
3. Sale by Co-Owner/Joint Owner (Sec.28)
4. Sale by a person in possession under voidable contract (Sec.29)
5. Sale by the seller in possession after sale (Sec.30(i); and
6. Sale by the buyer in possession after sale (Sec.30(ii).

1. Transfer of title by Estoppel (Sec.27) :— The expression 'estoppel' is derived from the French word 'Estoup', which means "shut the mouth". A person, who does an act in good faith at the words/conduct of another, should not be suffered/deceived. When the owner of the goods by his act or omission or conduct allows the buyer to believe that the seller has a right to sell the goods, he (true owner) cannot deny such sale subsequently.

Picard vs. Sears 1837 6A & E 469 : In this case, certain machinery was in the possession of a judgement debtor. The (true) owner of the machinery knowingly allowed it to be attached in execution as the debtor's property and did not make any claim till the machinery was sold in execution of the decree. It was held that

the owner was estopped from denying the title of the machinery in favour of the debtor, and the purchaser was entitled to the good title.

2. Sale by Mercantile Agent (Sec.27 proviso):— Sec.2 defines a mercantile agent. A Mercantile Agent is an agent, who is entrusted with the possession of goods or documents. He has an authority to sell the goods or consign them for sale. Eg.: Factor, Broker, Auctioneer etc.

The proviso to Sec.27 states that where a sale by a mercantile agent on behalf of the owner is made, such sale is an exception to the above rule/maxim. A sale by mercantile agent to be valid, the following conditions are to be satisfied:

1. The mercantile agent should be in possession of the goods or documents of the title thereto.
2. Such possession should be with the consent of the owner.
3. The sale is made in the ordinary course of the business.
4. The buyer should act in good faith; and
5. The buyer has notice of the seller's want of authority to sell.

Folker vs. King 1923 1 KB 283 : In this case, the plaintiff delivered his car to a mercantile agent to sell it for not less than £575. But the mercantile agent sold it to the defendant for £140 and misappropriated the amount. In an action by the plaintiff (owner), it was held that the defendant (buyer) had a good title to the goods.

3. Sale by Co-Owner/Joint Owner (Sec.28):— According to Sec.28 of the Act, if one of the joint owners, who is in possession of the goods sells them with the consent/permission of the other co-owners, the buyer gets a good title if he acts in good faith.

Juruk Chunder vs. Jodeshur Beng, LR 193 : In this case, a cow belonging to 3 persons was left in the sole possession of one of them; who sold it. It was held that the purchaser gets good title.

4. Sale by a person in possession under voidable contract (S.29): A voidable contract is one, which can be avoidable/ repudiated at the option of one party/parties, but not at the option of the other or others. Eg.:— A contract entered into out of a flaw in consent viz. coercion or undue influence or fraud or misrepresentation etc. is voidable. The person suffered loss as a consequence of the flaw in consent (i.e. the aggrieved party) only can avoid the contract, but not the other party.

According to Sec.19 of the Indian Contract Act, 1872, a contract is said to be voidable if it is induced by a flaw in consent (as stated above). Section 29 of the Sale of Goods Act, provides that "Where a person who has got the possession of goods under a voidable contract, sells them before the contract is rescinded/ repudiated by the aggrieved party, the buyer acquires a good title to the goods provided, the buyer has acted in good faith and without notice of the seller's defective title to the goods.

5. Sale by the seller in possession after sale (Sec.30(i):— According to Sec.30(i) of the Sale of Goods Act, where a seller, who is in possession of the goods or title deeds even after the sale, again sells the goods to another person, the seller can convey a good title to the buyer provided the buyer acts in good faith without the knowledge/notice of the previous sale.

6. Sale by the Buyer in possession after Sale (Sec.30(ii):— According to Sec.30(ii) of the Sale of Goods Act, where the buyer after sale or an agreement to sell, is in possession of the goods but not the title deeds, sells or pledges the goods to another, he can convey a good title provided the following conditions are satisfied.

i) the buyer is in possession of the goods or title deeds with the consent of the seller.

ii) the person buying from the buyer acts in good faith without any knowledge/notice as to the previous sale/ pledge.

12. Passing of Risk

The expression 'risk' means "liability to bear the loss, destruction or deterioration, that is caused to the subject matter (i.e. goods). In simple words, it means "a threat of loss or damage". The risk becomes loss on happening of the contingency. Section 26 of the Sale of Goods Act, says that "Risk prima facie passes with the title". It means "risk follows ownership, whether the goods are delivered or not and the price is paid or not. In other words, risk passes with the property or title in the goods.

The general rule is that "whoever is the owner of the property/ goods at the time of the loss, destruction or deterioration shall bear the loss". In a contract of sale, the goods remain at seller's risk, until and unless the property in goods (title) is transferred to the buyer. If the title is transferred, the goods are at buyer's risk, unless there is an agreement contrary to that effect".

Example :— 'A' sold his horse to 'B' for Rs. 10,000/-. 'B' paid the price and agreed to take delivery of the horse after 15 days. Meanwhile, i.e. on 10th day, the horse died. 'B' shall bear the loss. Suppose 'A', at the time of the contract of sale, agreed to bear the loss if any during the period under his ('A's) custody 'A' is bound to bear the loss.

Delay in Delivery :— Where the delivery of the property/ goods has been delayed by the fault or negligence of either seller or buyer, the goods are at the risk of the party (Seller or buyer), who delayed the delivery. The relevant case on this point is:

Demby Hamilton & Co. vs. Barden 1949 All ER 435 — The defendant contracted with the plaintiff to supply 30 tonnes of apple juice. The plaintiff prepared the juice and kept it ready for delivery. But the defendant delayed to take the delivery and the juice got spoiled. In an action by the plaintiff, the defendant (who delayed the delivery) was held liable to pay the price.

Case Comment (Part - C)

Q) Discuss the facts and law laid down in the case of G.I.P. Railway Co. vs. Hanmandas (N.U., April, 1999, Part-C, Q.18).

Ans. Instant case "**G.I.P. Railway Co. vs. Hanmandas (1890) L.R. 14** Bom 57" refers to **Sections 50 to 51** of the Sale of Goods Act, 1930, which deal with the **Seller's Right of the stoppage of Goods in Transit and Duration of the Transit** respectively.

Facts of the case :— The plaintiff in this case is the seller and the defendants are the G.I.P. Railway Co. The plaintiff sold the goods and transported them to the buyer through the defendant Railway Company. Meanwhile, the seller learnt from reliable sources that the buyer became insolvant/bankrupt. He sent a notice of stoppage in transit telegraphically to the defendant. The defendant received the telegram (to stop delivery to the buyer) from the plaintiff, when the goods were being loaded on to the buyer's cart. The defendant did not stop/cancel the delivery. The plaintiff sued the defendant.

Decision/Judgment :— The Court through Lord. Esher, held that the defendant Railway Co. is not liable on the ground that when once the goods are delivered to the buyer, the bailment is lost and the goods are not deemed to be in transit. Hence, the notice of stoppage in transit is ineffective/inoperative. The defendant Railway Co. has no right to cancel the delivery. Therefore, the plaintiff's action was not maintainable.

Issue/Question Involved: The Issue/Question involved in the instant case is :

1. Whether, the seller, after sale has a right to stop delivery of the goods in the transit? If so, what is the duration of the transit?

With regard to the above question, section 50 of the Sale of Goods Act, 1930 confers on the seller, the right to stop delivery in transit provided, the following conditions are satisfied:

1. the buyer becomes insolvent/bankrupt;
2. the seller is an unpaid seller/vendor; and
3. the goods are in transit.

However, the above right is subject to a limited duration as provided for under Sec.51 of the Act, which says:

1. The goods are deemed to be in the course of transit from the time they are delivered to the carrier or other bailee, until they are delivered (from the carrier or bailee) to the buyer/consignee or his agent.
2. When once the buyer or his agent takes/obtains delivery of the goods, the transit is at an end (i.e. transit comes to an end).
3. The transit is at an end, when the carrier/bailee acknowledges the buyer that the goods are at the appointed destination (reached the destination) and holds the goods on his (buyer's) behalf;
4. The transit is not deemed to be at an end (i.e. in transit) if the goods are rejected by the buyer and the carrier/ bailee continues to possess the goods even if the seller has refused to receive them back.

In view of the above, the defendant Railway Co. as bailee in the instant case, has no right to stop/cancel delivery of goods to the buyer as provided for in Sec.51(1) and (2) of the Act. Therefore, the plaintiff's action is not maintainable.

Basing on facts of the above case, problem may be formulated (as in the case of A.U.) as follows:

Problem :— 'A' of Ahmedabad sold goods worth of Rs. 50,000/- to 'B' of Bombay against a part-payment of Rs.10,000/-. 'A' consigned/transported the goods to 'B' by the North Eastern Carriers Private Limited. Later, 'A' learnt from reliable sources that 'B' became insolvant and sent a telegram to the carriers to stop delivery of goods to 'B'. The carriers had received the telegram, when the goods were delivered and being loaded on to buyer's cart. But, the carrier did not stop/cancel delivery of the goods. 'A' sued the North Eastern Carriers Pvt. Ltd., Decide.

Ans. Instant problem refers to Sections 50 and 51 of the Sale of Goods Act, 1930, which deal with **"Right of the Seller to stop delivery of goods in the transit and duration of the transit"** respectively.

The Relevant Leading Case on which the above problem formulated in **G.I.P. Railway Co. vs. Hanmandas (1890) L.R. 14 Bom.57**

Facts of the case:— as above

Decision/Judgement:— as above.

Issue/Question involved:— as above.

In view of the decision given in the above case, the plaintiff's ('A's) action in the instant case against the defendant (North Eastern Carriers Pvt. Ltd.) is not maintainable and hence, the defendant is not liable.

Problem :— The plaintiff purchased from a retailer two woollen dresses manufactured by the defendants. The plaintiff after wearing one of them became ill due to manufacturing defects in the goods. The plaintiff sued the defendant - Decide (A.U. Sept./Oct. 1999, Part-C, Q.4). (Clue: Implied condition as to quality or fitness: Sec. 16 : Sale of Goods Act, 1930).

Questions and How to Answer

Q) What is meant by goods under the Sale of Goods Act, 1930.

(A.U. Model Q.P. Part-A, Q-6 : 2 Marks); Define Goods?

(S.V.U. Nov.99, Part-A, Q.5 : 2 Marks)

Ans. Write about Definition, Meaning and Kinds of Goods in brief.

Q) What are conditions and warranties under the Sale of Goods Act, 1930? Explain different types of implied conditions and warranties recognised in the Act. (A.U. Model Q.P., Part-B, Q.3: Marks 18).

Ans. Write about Meaning and Definition of condition and warranty and different kinds of implied conditions and warranties in detail.

Q) What do you understand by "Caveat Emptor" (N.U. April, 99, Part-A, Q.8 : 2 Marks)

Ans. Write in brief about 'Caveat Emptor'.

Q) Sale by Sample. (N.U. April 99, Part-A, Q.9 : 2 Marks)

Ans. Sec.17 of the Sale of Goods Act, 1930 deals with "Sale by Sample". It is one of the kinds of implied conditions. Write now the meaning of implied condition and then explain about sale by sample in brief.

Q) "Risk prima facie passes with ownership" — Explain. (A.U. / Sept./Oct. Part-A, Q.8 : 2 Marks).

Ans. Write about 'Passing of Risk in brief'.

Further, questions may be asked as Sale and Agreement to sell and difference between the two, and Rights of an unpaid vendor (Vendor's Lien).

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Lecture - VI

CONTRACTS OF PARTNERSHIP
(The Indian Partnership Act, 1932)

1. The Indian Partnership Act, 1932

Partnership is a special kind of contract. Earlier, the law relating to partnership was governed by Chapter XI, containing Sections 239 to 266 of the Indian Contract Act, 1872. This chapter was repealed and replaced by a separate Act called the "Indian Partnership Act" in 1932. (Hereinafter called the Act). The Act contains 74 Sections and divided into 8 Chapters and two Schedules. Schedule I deals with "Maximum Fees", while the Schedule II was repealed by Repealing Act,1938 (1 of 1938).

Chapter I containing sections 1 to 3 contains preliminary aspects viz. short title, extent and commencement (Sec. 1)., section 2(a) to 2 (e) provide for definitions. Section 3 deals with application of the Act. The Act extends to the whole of India except the State of Jammu and Kashmir. Chapter II containing sections 4 to 8 deals with the nature of Partnership. Chapter III containing sections 9 to 17 explains the relations of partners to one another viz. rights, duties and liabilities of partners, conduct of business, profits earned by partners etc. Chapter IV containing sections 18 to 30 explain the relations of partners to third parties viz. status of partner as an agent of the firm; authority of partners, effect of admission of a new partner, minor partner etc. Chapter V containing sections 31 to 38 lays down the provisions for incoming and outgoing partners. Chapter VI containing sections 39 to 55 lays down the provisions relating to dissolution of the firm. Chapter VII containing sections 56 to 71 lays down the provisions relating to registration of firms. Supplemental provisions under sections 72 to 74 are enshrined in Chapter VIII. Finally, Schedule I contains various tables pertaining

to Maximum Fees., while Schedule II was repealed by the Repealing Act, 1938 (1 of 1938)

This lecture covers the following heads :

1. The Indian Partnership Act, 1932.
2. Partnership : Meaning and Definition.
3. Features of Partnership
4. Partnership and Joint Hindu Family.
5. Kinds of Partners.
6. Partnership and Agency (The Rule in Cox vs. Hickman).
7. Registration of Firm and Effects of Non-Registration.
8. Rights and Duties of Partners, and
9. Dissolution of Firm.

2. Partnership : Meaning and Definition

Partnership Meaning:— "When two or more persons (Subject to a maximum of 10 in Banking and 20 in Non-banking) carry on business to share profits and losses equally or in proportion of capitals, it is called partnership business." The persons are called 'Partners' and the business is called 'Partnership Firm'.

Definition :— Section 4 of the Indian Partnership Act, 1932 defines "Partnership", "Partner", "Firm and Firm Name".

"Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

"Persons, who have entered into partnership with one another are called individually "Partners" and collectively "a firm" and the name under which their business is carried on is called the "firm name".

3. Features of Partnership

To constitute partnership, the following ingredients are to be satisfied.

1. Association of two or more persons;
2. Agreement (Partnership Deed);
3. To carry on business;
4. Sharing of profits (equally or in proportion of capital);
5. Mutual agency (one acting for all and all acting for one).

1. Association of two or more persons :— To constitute partnership, there must be atleast two persons. The maximum number of persons is 10 if the firm carries on banking business and the maximum number of persons is 20 in respect of other business. The partnership gets dissolved if the number comes down to one (i.e. the number of partners is reduced to one).

2. Agreement (Partnership Deed) :— Partnership is the result of an agreement. Sec.5 says that, the relation of partnership arises from contract and not from status. The contract must fulfil the essentials of a valid contract viz. free consent, lawful consideration, legality of object etc. under Section 10 of the Indian Contract Act, 1872.

Partnership not created by Status (Sec. 5) : According to section 5, the relation of partnership arises from contract and not from status, and, in particular, the members of a Hindu undivided family carrying on a family business as such, or a Burmese Buddhist husband and wife carrying on business as such, are not partners in such business.

Goa, Daman and Diu : In Section 5, for the words 'a Burmese Buddhist husband and wife carrying on business as such', substitute the words 'a husband and wife under the regime of communion of property carrying a business as such'- Goa, Daman and Diu Amendment Act VI of 1966, Section 2 (w.e.f. 22.08.1966).

3. To carry on Business :— The object of every partnership must be to carry on business for the sake of profits and to share the same. Therefore, clubs or societies which do not aim at making profits are not partnerships. The term 'profits' has not been defined in the Act. It means net gain, i.e., the excess of returns over outlay. The very purpose of partnership is to carry on business to earn profit. According to Section 2(b) of the Partnership Act, the expression 'business' includes "every trade, occupation and profession". The business may be permanent or temporary or for a specific adventure.

Business on a small scale can be carried on by a single individual. It is called sole trading concern. If the business is to be carried on a large scale, public limited/Government companies requiring huge capital are to be established. The middle form of investment with division of labour, partnership is the best means to carry on business.

Mahadeodas v. Gherulal Parekh, A.I.R. 1958 Cal. 703 : In this case, the Calcutta High Court held that a partnership where the partners agree to engage in forward contracts without an intention of actual delivery but only to deal in differences, the agreement is merely wagering. Such a partnership is valid because the wagering agreements though they have been merely declared void, they are not illegal, immoral or opposed to public policy. Wagering agreement would be void if the business is forbidden by law, immoral or opposed to public policy within the meaning of Section 23 of the Contract Act. Thus, where a partnership between two persons to carry on business of transport service by obtaining permit in the name of one of them only involved the contravention of the provisions of Sections 42(1) and 59 (1), Motor Vehicles Act, the partnership is illegal and opposed to public policy. A claim on the basis of the settlement of accounts of such a partnership is also illegal and the same, therefore, cannot be enforced. The business which the partners agree to carry on must not be unlawful or opposed to public policy.

4. Sharing of Profits :— The term "Partnership" is derived from the word 'to part', which means "to divide". Thus dividing or sharing of profits is an essential feature of partnership and is contained in the partnership agreement/deed. The partners may share profits or losses equally or in proportion of their capitals as stated in the partnership deed. The ratio of sharing profits or losses varies from partnership to partnership.

Although sharing of profits is one of the essential elements of every partnership but every person who shares the profits need not always be a partner. For example, I may pay a share of profits to the manager of my business instead of payimg him fixed salary so that he takes more interest in the progress of the business, such person sharing the profits is simply servant or agent but not my partner. Similarly, a share of profits may be paid by a business man to a money-lender by way of payment towards the return of his loan and interest thereon, such a money-lender does not thereby become a partner. At one time it was thought that a person who shared the profits must incur the liability also as he was deemed to be a partner. This rule was laid down in ***Grace v. Smith, (1775) 2 Wm. Blacks. 998*** and it was stated by Grey C.J. that 'every man who has the share of the profits of a trade ought also to bear his share of the loss'. This principle was confirmed in 1793 in ***Waugh v. Carver, (1793) 2 H. Blacks 235 : 14 R.R. 845. IN 1860*** this question came for consideration before the House of Lords in ***Cox. v. Hickman, (1860) 8 H.L.C. 268 : 125 R.R. 148***. In that case it was laid down that the persons sharing the profits of a business do not always incur the liability of partners unless the real relation between them is that of partners.

5. Mutual Agency :— The expression 'mutual agency' denotes *"business carried on by all or any of them acting for all"*. In simple words, *"all act for one and every one acts for all"*. Thus, an act of partner is binding on the firm just like an act of an agent is binding on the principal. Therefore, it is said that *"The*

law of partnership is an extension of the law of agency or law as to partnership is undoubtedly a breach of the law of principal and agent". (The Rule in *COX vs. Hickman*).

This existence of mutual agency is to be there in every partnership. In *Cox v. Hickman*, (1860) 8 H.L.C. 268, we have already noted that although the trustees were managing the business of Smith and Sons, they did not thereby become partners. The reason is that the trustees were merely agents of Smith & Sons but they were not the principals and thus there was no mutual agency. Smith and Sons were principals and business still belonged to Smith & sons and not to trustees. Similarly, if the servant of an agent is paid remuneration out of profits, such a person constitutes merely an agent of the person with whom he is sharing the profits. Since such a servant or agent does not occupy the position of a principal, there is no mutual agency and thus the servant or agent sharing the profits cannot be termed as a partner.

4. Partnership Firm and Joint Family Firm

Following are the notable points of distbinction between Partnership Firm and Hindu Joint Family Firm -

Partnership Firm	Joint Hindu Family Firm
1 The relation of partnership arises from contract, and not from status.	1.The relation of Joint Hindu Family firm arises from status, and not from contract. It arises by operation of law.
2. Every partnership firm is governed by the provisions of Indian Partnership Act, 1932, Indian Contract Act, 1872 etc.	2. Every joint Hindu Family firm is governed by the codified and uncodified Hindu Laws.
3. The interest of the partners in a of a partnership firm is determined by contract.	3. The interest of the members Hindu Joint Family firm in ancestral business is acquired by status, i.e. by birth.

Partnership Firm	Joint Hindu Family Firm
4. A partnership firm may be constituted irrespective of the members' caste and religion.	4. A Joint Hindu Family firm is limited to Hindu religion, that too the caste to which the members belong.
5. A partnership firm is dissolved by death, insanity of a partner.	5. A Joint Hindu Family firm is not dissolved by death or insanity of a family member.
6. No person can be introduced as a partner without the consent of all the partners (Sec. 31)	6. A member of a Joint Hindu Family acquires an interest in the firm business by birth, marriage, adoption etc. No consent of other members is necessary. Other members cannot deprive his right.
7. Partnership is a specific application of the principles of agency. It is often said "The law of partnership is undoubtedly, a branch of the law of Principal and Agent".	7. The principle of agency does not apply in case of Joint Hindu Family firm.
8. There is restriction on the maximum number of members in the case of a partnership firm. Minimum two and maximum twenty partners are allowed.	8. There is no such restriction.
9. The liability of the members is not limited to the extent of his interest in the assets of the partnership firm.	9. The liability of the members is limited to the extent of his interest in the assets of Hindu Joint Family.

Partnership Firm	Joint Hindu Family Firm
10. Doctrines of Holding Out and Estoppel are applicable.	10. Doctrines of Holding Out and Estoppel are not applicable.
11. A person can be admitted as a partner in the firm due to his money, reputation, skillness, ability etc.	11. A person can be admitted as a member in a Joint Hindu Family by the fact of marriage, birth, adoption.

5. Kinds of Partners

Partners may be categorised under the following heads namely:—

1. Active Partner (works actively in firm);
2. Sleeping Partner (does not work, but invests capital);
3. Nominal Partner (firm uses his name for reputation);
4. Partner by Estoppel or Holding out (keeps silence when announced as partner before others); and
5. Minor Partner.

(The most important among the above are 'Partner by Estoppel or Holding out' and 'Minor Partner', which are discussed below in detail).

1. Active Partner :— An active partner is one, who takes active part in the conduct of the business. He becomes partner by an agreement and his acts are binding on the firm.

2. Sleeping Partner : — A Sleeping Partner is one, who invests capital and share profits or losses along with other partners, but does not take an active part in the conduct of the business in the firm. He is not known to the outsiders as a partner of the firm. He has a right to examine the accounts of the firm.

3. Nominal Partner:— A nominal partner is one, who allows the firm to use his name to gain benefit. He neither invests capital nor claims share in the profits or takes part in the business. He is not a partner in reality. However, he is liable/answerable for all acts of the firm as if he were a partner.

4. Partner by Estoppel or Holding Out :— The expression 'estoppel' is derived from the French word 'estoup', which means "shut the mouth". It is based on the *principle of equity and good conscience.* It (estoppel) is enshrined in the latin maxim *"Allegans contraria audi erdus"*, which means "a man alleging contradictory facts ought not to be heard". The object of the principle of estoppel is to prevent fraud and to manifest good faith among the parties. Holding out is a branch of the principle of estoppel.

When a person by an act or omission makes/induces another to believe a thing, cannot deny its truth subsequently. *Eg.:*— 'A' a partner of firm says 'B' in the presence of 'C', that 'C' is his partner. In fact, 'C' is not the partner. If 'C' keeps quiet (keeps silence by shutting his mouth) without denying 'A's words, 'C' is deemed to be the partner of that firm and is called "Partner by estoppel".

Partnership is a special kind of contract, which is created generally out of an agreement. A partnership by estoppel is an exceptional case/situation, where even in the absence of an agreement/contract (like a quasi contract), a partner becomes liable as if he were a partner. When a person represents himself or allows/permits himself to be represented to be a partner in a firm, and a third party on the faith of that representation gives credit to the firm, he becomes liable as a partner to such third party. Such a partnership is called the *"Partnership by estoppel or holding out".* Sec.28 of the Indian Partnership Act, 1932 deals with the partner by Estoppel or Holding out. A partner by estoppel or holding out has no right to claim any share in the profits of the firm. But, he has a liability against the third person/parties, who have dealt with

the firm by acting in good faith under the impression that he is a partner of the firm.

The principle of holding out was laid down by Iyer, C.J. in *Waugh vs. Carver* (1793) 2 HBL 235, "that a person holding himself out as a partner, and thereby inducing others to act on the good faith of his representations, is liable to them as if he were in fact a partner".

5. Minor Partner (Minor as Partner) :— According to Section 3 of the Indian Majority Act, 1875, a minor is a person who has not completed the age of 18 yeas. The minority extends to 21 years if a guardian of minor's person or property is appointed (under the Guardians and Wards Act 1890). In England, a person below the age of 21 years was a minor till 1969. With the passing of the Family Reforms Act, 1969, the age of minority is reduced to 18 years.

Legal status/position of Minor as Partner :—

According to Section 11 of Indian Contract Act 1872, a contract with minor is *void abinitio* i.e. not valid from the very beginning. This view was laid down by the Privy Council in *Mohoribibi vs. Dharmadas Ghose* 1903 30 IA Cal. 539.

However, according to Sec.30(i) of the Indian Partnership Act, 1932, a minor can be admitted as a partner for the benefits of partnership with the consent of other partners. This provision is based on the rule that *"a minor cannot be a promisor, but he can be a promisee or beneficiary."* In other words, he can share gains, but he is not liable for losses. Thus, a minor can only be admitted to the benefits of the partnership and cannot be a full-pledged partner (*Addl. C.I.T. vs. U.K.P. Kumar* AIR 1978 All 397).

Position of Minor as Partner :—

The position of Minor as Partner may be explained with reference to the following heads :

i) Before attaining Majority;

ii) After attaining Majority.

i) Before attaining Majority :— Following are the rights and liabilities of Minor before attaining Majority.

Rights : 1. He has a right to get share in the property and profits of the firm. He cannot, however, sue for an account or payment of his share.

2. He has a right to inspect and copy the accounts of the firm (Section 30(2).

3. He has a right to sue the firm for his share of profits (Section 30(4).

Liabilities : 1. His liability is limited (not unlimited like other partners) (Section 30(3). If the firm becomes insolvent, his personal assets will not be affected.

2. He cannot be declared/adjudged insolvent. If the firm is adjudged insolvent, his share in the firm is vested in the official receiver.

ii) After attaining Majority:

1. Within six months after attaining the majority, he has to declare through the public notice, whether he wants to continue as partner or not. If he keeps silence it amounts to continuation.

2. If he decides (elects) to continue as partner, he is liable like other partners (Section 30(7)(a).

3. If he decides (elects) not to continue as partner, his rights and liabilities as minor continue upto the date of the public notice (Section 30(8)(a).

The public notice is to be given in the following manner:

i) to the Registrar of Firms Under Sec.63(2) of the Partnership Act so as to make necessary entries to that effect in the Registrar of Firms.

ii) it should be published in the local official gazette.

iii) it should be published at least in one vernacular newspaper, having circulation in the District, in which the firm has its place of business (Sec.72).

Position in England :

In England, a minor can become a partner in a firm. He is not liable for the liabilities of the firm. His share in the firm and the share of profits, is subject to liability from the date of his attaining majority.

6. Partnership and Agency

(The Law of Partnership is an Extension of the Law of Agency or Law as to Partnership is undoubtedly a Branch of the Law of Principal and Agent or the Rule in *Cox vs. Hickman*)

Partnership is the relation between persons who have agreed to share the profits of business carried on by all or any one of them acting for all. The main ideal of partnership is "Mutual Agency i.e. every one acts for all and all act for one". In the eyes of law, every partner is an authorised agent of the firm. Thus, the relationship of principal and agent is created between/among the partners and hence the relationship is governed by the law of agency. Sec.18 of the Partnership Act says that a partner is an agent of the firm. Sec.19 confers on the partner implied authority to act as an agent of the firm.

It is said that *"Partnership is an extension of the law of Agency"*. The following similarities between the agency and the partnership justify this statement:

1. The relation between the Principal and Agent is similar to that of the firm and partner since the partner is an authorised agent of the firm (Section 18, Partnership Act) and hence, the firm is regarded as the Principal.

2. In agency, notice to an agent is treated as the constructive notice to the Principal. Similarly, in partnership, an information brought to the notice of a partner, is treated as the notice to the firm.

3. The principle of vicarious liability is applicable to both the cases i.e. Agency and Partnership. In agency, principal is vicariously liable for the acts/wrong committed by the agent. Similarly, the firm is liable for the partner's acts done in the ordinary course of business.

4. An agent should not make any secret profits. Similarly, a partner cannot do so.

5. Section 189 of the Indian Contract Act confers emergency powers on agent. Similar power is conferred on partner under Sec.21 of the Partnership Act.

6. Lastly, there is agency by estoppel or agency by holding out. Similarly, there is partnership by estoppel or partnership by holding out. Such person (Agent or Partner) is liable to the third person who contracted with the principal/firm on the belief that he is also an agent/partner.

In view of the above similarities between the 'Law of Agency' and the 'Law of Partnership', it is said that "Partnership is an extension of the Law of Agency". It was laid down in the leading English case:

COX vs. Hickman (1860) 11 ER 431 : that "the law as to partnership is undoubtedly a branch of the law of the principal and agent". The House of Lords observed, "the liability of one partner for the acts of his co-partners is in truth the liability of a principal for the acts of his agent. Every partner in trade is for the ordinary purposes of the trade, the agent of his co-partner and all are, therefore liable for the ordinary trade contracts of the other".

Facts of the case :— In this case, Smith and his son carried on partnership business as Smith & Son. Owing to financial crisis, they assigned the business to certain creditors as trustees to carry on the business and discharge the debts. While the business was

being managed by the trustees (creditors), the plaintiff, Hickman supplied goods to the firm and sued the firm, for payment. The defendant Cox, who was one of the trustees of the firm was sued as partner though he did not take part in the transaction. It was held that the defendant was not liable on the ground that there was no partnership.

The House of Lords through Lord, Wensleydale enunciated that participation in profits is not the real test of partnership. The above rule laid down in this case is popularly known as "the Rule in *Cox vs. Hickman*".

7. Registration of Firm & Effects of Non-Registration

The Indian Partnership Act, 1932 (hereinafter called the Act) makes provision for registration of a partnership firm. It is only optional and not compulsory. However, an unregistered firm suffers from certain disabilities. So, to avoid such disabilities, it is better, to get the firm registered under the Act. Chapter VII, containing Sections 56 to 71 of the Act provides for the registration of a firm. Section 69 of the Act deals with the disabilities as a consequence of non-registration.

Procedure for Registration :— Sec.57 empowers the State Government to appoint the Registrar of Firms for the purpose of registering the partnership firms. (The Government of Andhra Pradesh appointed a Registrar of Firms. His jurisdiction extends to entire State.

To reduce the workload of the Registrar of Firms, A.P., and facilitate the process of registration, the Registrars of Stamps and Registration in the Districts were empowered to register the partnership firms in their Districts from the year 1996).

A partnership firm may be registered at any time during its existence. The registration may be made even on the event of a suit. For the purpose of registration, the prescribed application duly

filled in, signed and verified by the partners, accompanied by the requisite registration fee should be submitted to the Registrar.

The application contains the following particulars (Section 58).

a) the firm name;

b) the place or principal place of business of the firm;

c) the names of any other places, where the firm carries on business;

d) the date, when each partner joined the firm;

e) the names in full and permanent addresses of the partners; and

f) the duration of the firm.

The Registrar having satisfied that the particulars are complied with the provisions under Sec.58 of the Act, registers the firm by making an entry in the Register of firms and issues a Certificate of Registration (S.59). The registration comes into force with effect from the date, when the Registrar records/enters the statement in the Register (Under Sec.59) and not the date of application for registration (*Popular Films vs. Nalini Saigal,* 84 Cal WN 867). If the particulars furnished in the application are incomplete, the Registrar rejects the application. Further, any person, who furnished false information in the application shall be punishable with imprisonment, which may extend to three months or with fine or with both (Sec.60).

Alteration/Change of Particulars (Sec.60):— When an alteration is to be made with regard to the firm name, place of business, a statement to that effect signed by all the particulars is to be sent to the Registrar (Sec.60(1). If the Registrar is satisfied that the provisions under Sec.60(1) are complied with, incorporates necessary change/alteration in the Register of Firms.

Jayalaxmi Oil Mills vs. Income-Tax Commissioner, AIR 1976 AP 9:— The A.P. High Court held in this case that, registration

is complete when the statement in the prescribed form signed and verified by all the partners accompanied by the prescribed fee is presented to the Registrar. The act of the Registrar making an entry in the Register of Firms is only a clerical act.

Effects of Non-Registration (Sec.69) :— Section 69 of the Indian Partnership Act, 1932 deals with the effects of non-registration of a partnership firm. Though the Act does not insist registration compulsory, imposes certain disabilities on an unregistered firm. The disabilities or effects of non-registration are explained below:

1. Partner cannot sue:— A partner of an unregistered firm has no right to sue the firm or any one of its partners, past or present to enforce the rights conferred under the Partnership Act or arising out of the contract (Sec.69(1).

2. Firm cannot sue :— An unregistered firm cannot sue a third party to enforce a right arising from a contract (Sec.69(2).

3. Claim of Set-off :— An unregistered firm or its partner cannot plead set off in a proceeding instituted against the firm by a third party to enforce a right arising from a contract, until the registration of a firm is effected (Sec.69(3).

Exceptions :— Sec.69(3) of the Partnership Act, 1932 provides for certain exceptions. In other words, non-registration of the firm, however has no effect in respect of the following cases:

i) suit for accounts of a dissolved firm;

ii) suit for dissolution of the firm;

iii) suit for realising the property of a dissolved firm;

iv) proceeding by an Official Assignee or Receiver to realise the property of an insolvent partner; and

v) claim of set off not exceeding Rs.100/- provided it is not of a small cause nature.

Navinchandar vs. Mollchand AIR 1966 Bom. 111 : In this case, the Bombay High Court held that a suit for damages for misconduct can be brought by one partner against another eventhough the firm is not registered.

D.G. Sahu vs. Indian Mills Stores, Rajpur 1977 MPLJ 491 : It was held in this case that "no fresh registration is necessary/ required, when a new partner is admitted into the firm".

8. Rights and Duties of Partners

Chapter-III, containing Sections 9 to 17 of the Indian Partnership Act, 1932 entitled "Relations of Partners to one another" lays down the provisions relating to "Rights and Duties of Partners". Partnership is a special kind of contract/agreement. It need not be in writing and its registration also is not necessary/compulsory. However, to avoid future disputes, the relation of partnership is created by means of a written instrument called "the partnership deed". Further to avoid certain disabilities, of non-registration, it is desirable to register the partnership firms. Section 11 of the Partnership Act empowers the determination of rights and duties of partners by agreement between them. Such agreement/contract may be expressed in the partnership deed or may be implied by a course of dealing.

Rights of Partners :— If the partnership agreement is silent as to (does not contain) the rights of the partners, the following provisions as laid down in the Partnership Act are applicable:

1. Right to take part in conduct of the business (S.12(a);
2. Right to be consulted (S.12(c);
3. Right to access to books (S.12(d);
4. Right to Indemnity (S.13(e);
5. Right to claim remuneration, profits and interest on Capital (S.13(a), 13(b) and 13(c&d).

1. Right to take part in conduct of the business (S.12(a):— Section 12(a) of the Partnership Act confers on every partner a right to take active part in the conduct of the business.

2. Right to be consulted (S.12(c) :— Section 12(c) of the Act insists/imposes that every partner has to be consulted and heard in all matters pertaining to the business. The business matters are divided into two categories namely (i) ordinary matters; and (ii) fundamental matters. The former can be settled by majority opinion of the partners, while the latter can be settled only with the consent of all the partners.

3. Right to access to books (S.12(d) :— Section 12(d) says that every partner has a right to have access to inspect and take copies of any books and accounts of the firm.

4. Right to Indemnity (Sec.13(e) :— The term 'Indemnity' means "Promise to make good the loss". According to Section 13(e), every partner has a right to claim indemnity from the firm (or to be indemnified by the firm). This right is available against payments made by him for conduct of the business and for acts done in emergency to save the firm from losses.

Thomas vs. Atherton 1877 10 Ch. D 185 — In this case, there was a dispute between two firms pertaining to their boundaries. One partner of a firm, who trespassed the boundary, was asked to pay compensation. He paid the compensation and claimed indemnity from the firm for the compensation paid. In an action against the firm for indemnity, it was held that the plaintiff (partner) is not entitled to the right of indemnity on the ground that trespass in no way connected with the business.

5. Right to claim remuneration, profits and interest on capital :— Sections 13(a), 13(b) and 13(c&d) of the Partnership Act, confer on partner right to claim remuneration, profits and interest on capital respectively.

Duties of a Partner :— Section 11 of the Act empowers the duties (and rights) to be incorporated in the partnership agreement. In the absence of such arrangement (i.e. the duties are not contained in the agreement), the following provisions as laid down in the Partnership Act are applicable:

1. Duty to carry on business for common advantage (S.9).
2. Duty to render true accounts (S.9)
3. Duty to indemnify loss (S.10)
4. Duty to attend deligently (S.12(b); and
5. Proper use of firm's property (S.15 & 16(a).

1. Duty to carry on business for common advantage (S.9):— The very ideal of partnership business is 'mutual agency' i.e. "every one acts for all and all act for one". Every partner has a duty to strive hard for the growth and progress of the firm for the common advantage and should not resort to personal/secret profits.

Bentley vs. Graven 1853 Beav.. 75 — In this case, the defendant a partner purchased sugar for the firm at higher price from his personal stock and thereby earned personal profit. In an action by the firm, the court directed the defendant to account for the profit so gained.

2. Duty to render true accounts (S.9):— Section 9 imposes on every partner duty to act in utmost good faith. Where a partner is entrusted with the conduct of business and to maintain the account, he has a duty to render true and correct accounts. He must also permit/allow the other partners to inspect the accounts and to take copies thereof.

3. Duty to Indemnify loss (S.10):— Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm. This duty is absolute and no partner is exempted in this regard.

4. Duty to attend diligently (S.12(b) :— Every partner to the best of his knowledge and skill must attend deligently to his duties in the conduct of the business of the firm.

5. Proper use of Firm's property (Ss.15 & 16(a) :— Section 15 imposes duty on every partner that the property of the firm shall be held and used by the partners exclusively for the purposes of the business. Further *Section 16(a) says that "if a partner derives any profit* for himself from any transaction of the firm or *from the use of the property* or business connection of the firm or the firm name, *he shall account for that profit and pay it to the firm.*

9. Dissolution of Partnership Firm

Dissolution of Firm - Meaning & Definition :— Dissolution of firm means 'Putting an end to partnership business'. After dissolution, the firm exists no more. Chapter-VI containing Sections 39 to 55 of the Indian Partnership Act, 1932 deals with dissolution of a Partnership Firm.

According to Section 39 of the Indian Partnership Act, 1932 "Dissolution of a firm means complete break down or extinction of relationship between all the partners of a firm".

Dissolution of Partnership :— Dissolution of Partnership is different from the Dissolution of Firm. Where there is a breakdown of the relation between one or more partners and the firm, it is called dissolution of partnership". The firm continues to exist even after the dissolution of partnership of one or more partners provided atleast two partners continue to exist in the firm.

If the relationship of all partners except one partner with the firm comes to an end, it is called the dissolution of the firm. In dissolution of partnership two or more partners survive and continue the business.

Lecture VII

NEGOTIABLE INSTRUMENTS (The Negotiable Instruments Act, 1881) as amended by The Negotiable Instruments (Amendment) Act, 2018

This lecture covers –

1. The Negotiable Instruments Act, 1881
2. Negotiable Instrument : Meaning & Definition
3. Features of Negotiable Instrument
4. Kinds of Negotiable Instruments
   - A) Promissory Note (Sec.4)
   - B) Bill of Exchange (Sec. 5)
   - C) Cheque (Sec. 6)
5. Crossing of Cheques
6. Parties to the Negotiable Instrument
   - A) Holder (Sec. 8)
   - B) Holder in Due Course (Sec.9)
   - C) Payment in Due Course (Sec. 10)
   - D) Drawee in case of Need
   - E) Holder for value.
7. Endorsement
8. Assignment and Negotiation
9. Kinds of cheques
10. Marking of Cheques
11. Material Alteration

Modes of Dissolution of Partnership Firm:— Partnership firm may be dissolved under the following modes:

I) Without the Order/Intervention of the Court:

1. By agreement (Section 40);
2. Compulsory dissolution (Section 41); (lack of minimum number of partners, insolvency, illegality etc.)
3. Dissolution on the happening of certain contingencies (Sec. 42); (completion of object, expiry of time, death etc.)
4. Dissolution by notice of partners at will (Sec.43); (by giving notice by partners).

II) Dissolution by the Court (Section 44):

1. Insanity of partner;
2. Permanent incapacity;
3. Misconduct;
4. Breach of agreement;
5. Business working at losses; and
6. Any other ground.

I) Without the order of the Court (Sections 40 to 43):

1. *By Agreement (Section 40):—* Partnership firm comes into existence out of an agreement between/among the partners. According to Section 40 of Indian Partnership Act, the firm may be dissolved with the consent of all the partners or in accordance with a contract between them. This provision for dissolution may be contained in the original agreement (i.e. partnership deed) or new agreement may be entered into to that effect.

2. *Compulsory Dissolution (Section 41):—* According to Sec. 41, a firm may be dissolved compulsorily.

a) by the adjudication of all the partners or of all the partners but one as insolvent; or

b) by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

Provided that, where more than one separate adventure or undertaking is carried on by the firm, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of all its lawful adventures and undertakings.

In simple words, a firm may be dissolved under the following cases:

a) *Lack of Minimum Number:*— If the number of partners is reduced to one, the firm is to be dissolved compulsorily.

b) *Insolvency of Partners:*— If the partners become bankrupt, the firm stands dissolved.

c) *Illegality of business:*— If the business is declared illegal by an act of Government or Legislation, the firm is dissolved. Ex.:—Ban on arrack business.

3. Dissolution on the happening of certain contingencies (S.42):— According to Section 42 of the Act, a firm is dissolved upon the happening of any one of the following events (unless there is an agreement to the contrary);

a) *Expiry of time:*— If the firm is started for a fixed period. After the expiry of the period, the firm is dissolved.

b) *Fulfilment of the object:*— If the firm is constituted to carryout one or more adventures or undertakings, by the completion thereof; the firm may be dissolved, upon the fulfilment of the object for which it is established.

c) *Death:*— Death of a partner may result in dissolution of the firm; and

d) *Insolvency of a partner:*— The firm may be dissolved by the adjudication of a partner as an insolvent.

4. Dissolution by notice of partners at will (Sec.43):— A firm may be established by partnership at will. In this case, the term or duration of the partnership is not fixed and the firm may be dissolved by any partner by giving notice in writing to other partners.

II) Dissolution by the Court (Section 44):

According to Section 44 of the Act, a partner may file suit for dissolution of the firm, and the court may order dissolution of the firm on any one of the following grounds:

a) *Insanity:*— Where a partner has become insane (unsound mind) the Court may order dissolution of the firm against a suit by any partner (Section 44(a).

b) *Permanent Incapacity:*— Where a partner has been incapacitated from performing his duties as partner, any other partner/partners may sue for dissolution (Section 44(b).

c) *Misconduct:*— Where a partner is found guilty of misconduct, any other partner may sue for dissolution (Section 44(c).

d) *Breach of Agreement:*— If a partner wilfully or persistently commits breach of agreements relating to the management of the affairs of the firm, any other partner may sue for its dissolution.

e) *Transfer of Interest:*— Where a partner, transfers the whole of his interest in the firm to a third party the other partner may sue for its dissolution.

f) *To save the business from Losses:*— If the firm is running at losses, any partner may sue in the court for order of dissolution; and

g) *Any other ground:*— The firm may be dissolved on any other ground, which renders it just and equitable.

Case Comment (Part-C)

Q) Discuss the facts and law laid down in Cox vs. Hickman (N.U Model).

Ans: *Cox vs. Hickman* (1860) 11 ER 431:

Instant case refers to the "test to determine partnership" as embodied in Explanation 2 to Section 6 of the Indian Partnership Act, 1932 and the relation between partnership and agency.

Facts of the Case:— Mr.Smith and his son were carrying on partnership business as 'M/s. Smith & Son. Owing (due) to financial difficulties, they assigned the business to their creditors and executed an agreement/document to that effect. According to the agreement, the business was to be managed by five trustees representing the creditors under the name of 'Stanton Iron Co'. The trustees include Cox and Haywood. The net income/profit (after paying off the creditors) was to be distributed by the trustees. After all the creditors had been paid off, the business had to be retransferred to M/s. Smith & Son. The creditors were empowered to discontinue the business or to make rules for conducting the business. While the business was being managed by the trustees, Hickman, plaintiff in this case supplied goods to the firm (and drew a bill, which was accepted by Haywood i.e. Haywood had undertaken to pay) Cox did not accept the trusteeship and did not take part in the transaction. Hickman sued the firm for payment treating Cox and Haywood as partners.

Judgment:— The House of Lords held that there was no partnership and Cox was not liable. Lord Cranworth held that participation in profits is not the decisive test of a partnership. The true test is, whether there exists 'mutual agency' between/among the partners.

Principle:— The principle involved in the instant case is:

Explanation 2 to Section 6 of the Indian Partnership Act, 1932, which reads as follows:

"The receipt by a person of a share of the profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, does not by itself make him, a partner with the persons carrying on the business;

and, in particular, the receipt of such share or payment—

a) by a lender of money to persons engaged or about to engage in any business;

b) by a servant or agent as remuneration;

c) by the widow or child of a deceased partner, as annuity; or

d) by a previous owner or part owner of the business, as consideration for the sale of the goodwill or share thereof, does not of itself make the receiver a partner with the persons carrying on the business.

The principle that "a person, who has a share in profits of a business" as laid down in 'Waugh vs. Carver (1793) 126 ER 525 was overruled in this case by the House of Lords. Lord Cranworth enunciated that "participation in profits is not the decisive test of a partnership. The true test is whether there is mutual agency among the members of the association". He says that "the law as to partnership is a branch of law of principal and agent". Thus, the true or decisive test of partnership is "mutual agency".

Explanation 2 to Section 6 says that a lender cannot become a partner with the borrower (debtor) simply because, he stipulates for a percentage of the profits of the borrower's business as consideration for his lending money. The relationship was that of the debtor and creditor and not of partnership. It further says that a

servant or an agent remunerated by a share of profits does not thereby become a partner.

Conclusion :— It is clear from above discussion that sharing of profits is one of the constituents/ingredients of partnership. However, it is not a true or decisive test. The true test is "mutual agency", which does not exist in the instant case. Therefore, Cox cannot be regarded as a partner and hence, he is not liable.

Basing on the above case, problem may be framed as follows (A.U. Model).

Problem :— 'X' and his son 'Y' were carrying on partnership business 'X' & 'Y' Traders. Owing (due) to financial difficulties, they assigned the business to their creditors and executed an agreement/document to that effect. According to the agreement, the business was to be managed by five trustees representing the creditors - under the name 'Standard Iron Co.'. The trustees include 'A' and 'B'. The net income was to be distributed by the trustees. After all the creditors had been paid off, the business had to be retransferred to 'X' & 'Y' Traders. The creditors were empowered to discontinue the business or to make rules for conducting the business. While the business was being managed by the trustees, 'C' supplied goods to the firm and drew a bill. 'B' accepted the bill. 'A' did not accept the trusteeship and did not take part in the transaction. 'C' sued the firm for payment treating 'A' and 'B' as partners - Decide.

Ans : Instant problem refers to the "test to determine partnership", as enumerated under Explanation 2 to Section 6 of the Indian Partnership Act, 1932 and the relation between partnership and agency.

The relevant leading case of the instant problem is :

Cox vs. Hickman (1860) HER 431

Issues Involved :— The issues involved in the instant problem are :

1. Whether partnership relation exists between 'A' & 'B' and the firm?
2. Whether 'A' and 'B' are liable?

With regard to the first issue, to constitute partnership, there must exist "mutual agency", which is the true or decisive test to determine partnership. In the instant problem, the mutual agency does not exist between/among the trustees and hence, there is no partnership.

Regarding the second issue, whether 'A' and 'B' are liable? 'A' and 'B' can be made liable if they are partners. In the instant problem 'A' and 'B' trustees represent the creditors. The relation of 'A' and 'B' with the firm is that of the creditors and the debtor and not that of the partners and firm. Therefore, 'A' and 'B' are not partners and hence they are not liable.

The decision of the House of Lords in *Cox vs. Hickman* answers the above questions in detail as follows:

Cox vs. Hickman (1860) 11 ER 431

Facts of the Case : Refer Page No. 116

Judgement : Refer Page Nos. 116

Principle : Refer Page No. 116

Conclusion :— In view of the above, 'A' and 'B' being trustees are entitled to share/distribute profits. Sharing of profits is one the ingredients of partnership. However, it is not a decisive test. The true and decisive test is "mutual agency", which does not exist in the present problem. Thus, the relation between the trustees 'A' and 'B' and the firm is that of the creditors and the debtor and not that of the partners and the firm. Therefore, 'A' and 'B' are not liable as partners.

Problem :— 'A', 'B' and 'C' enter into a partnership to carry on business in grain but do not get the partnership registered. The firm sells goods on credit to 'D' and a large amount is due from him to the firm. Meanwhile, 'B' dies. 'A' collects half of the amount due from 'D' and refuses to account it to 'C', 'D' also refuses to pay the balance. What, if any, is the remedy open to 'C' (A.U. Model Q.P., Part-C, Q.No.4).

(Clues:— 1) Sec.69: Effects of non-registration. A partner of an unregistered firm cannot sue to enforce a right arising out of a contract. 2) On B's death, the firm gets dissolved. Sec. 69 permits C to sue for accounts of a dissolved firm even if it is not registered. 3) A partner has a right to realise the property of a dissolved firm. Therefore, C can sue D for recovery of the debt due to the dissolved firm *Sethia vs. I.B. Johu,* AIR 1977 SC 336.

Questions & How to Answer

Q) Write a note on partnership firm (A.U. July 2000, Part-A, Q.6: 2 Marks) and Define Partnership (S.V.U.November '99, Part-A, Q.6 : 2 Marks).

Ans: Write the meaning and definition of partnership, partner and firm and firm name (S.4) in brief.

Q) Explain dissolution of firm (A.U. September '99, Part-A, Q.10 : 2 Marks)

Ans. Write about dissolution of firm in brief i.e. in a paragraph/ one page.

Q) Define partnership and discuss how a partnership firm can be dissolved.

Ans. Write in detail meaning, definition and dissolution of the partnership.

Q) What are essential elements of contract of partnership? (A.U. Model Q.P., Part-A, Q.8, 2 Marks)

12. Forgery of Customer's Signature
13. Notice of Dishonour
14. Criminal Liability of the Drawer of a Cheque (Cheque Bouncing)
15. The Paying Banker (Statutory Protection to the Paying Banker)
16. The Collecting Banker (Statutory Protection to the Collecting Banker)
17. Closing of a Bank Account.

1. The Negotiable Instruments Act, 1881

(As amended by the Negotiable Instruments (Amendment) Act, 2018)

The Negotiable Instruments are playing a vital role in the business world. The instruments which are transferable by delivery or by endorsement and delivery may be called negotiable instruments e.g. Promissory Notes, Cheques, Bills of Exchange etc. The law relating to Negotiable Instruments in India is governed by the Negotiable Instruments Act, 1881 (As amended by the Negotiable Instruments(Amendment) Act, 2018). It is originated from the English Common Law and is borrowed from the English Legislations relating to the negotiable instruments viz. the Bills of Exchange Act, 1882. The Negotiable Instruments Act was passed in 1881 and came into force from 1st March 1882. It extends to the whole of India (The Words "Except the State of Jammu & Kashmir" omitted by Act 62 of 1956 under Section 2 and Schedule w.e.f. 01.11.1956), but nothing herein contained affects the Indian Paper Currency Act, 1871.

The Negotiable Instruments Act contains 148 Sections divided into 17 Chapters and Schedule (repealed by the Amendment Act, 12 of 1891). Chapter I containing sections 1 and 2 contains

preliminary aspects. Section 1 contains title, extent and applications. Section 3 contains Interpretation clause and defines the term Banker (Sec. 2 : Repeal of enactments). Chapter II containing sections 4 to 25 lays down the provision relating to "Notes, Bills and Cheques". Chapter III containing sections 26 to 45 deals with "parties to Notes, Bills and Cheques". Chapter IV containing sections 46 to 60 lays down the provisions relating to 'Negotiation'. Chapter V containing sections 61 to 77 lays down the provisions of presentment. Chapter VI containing sections 78 to 81 makes provisions relating to Payment and Interest. Chapter VII containing sections 82 to 90 provides the provisions relating to "Discharge from liability on Notes, Bills and Cheques". Chapter VIII containing sections 91 to 98 deals with "Notice of Dishonour". Chapter IX containing sections 99 to 104A lays down the provisions of Noting and Protest. Chapter X containing sections 105 to 107 makes provisions of "Reasonable Time". Chapter XI containing sections 108 to 116 deals with "Acceptance and Payment for Honour and Reference in case of Need". Chapter XII containing section 117 makes provisions of compensation. Chapter XIII containing sections 118 to 122 provides for "Special Rules of Evidence". Chapter XIV containing sections 123 to 131A contains provisions of crossed cheques. Chapter XV containing sections 132 and 133 contains provisions of "Bills of Sets". Chapter XVI containing sections 134 to 137 contains provisions of "International Law" and finally Chapter XVII containing sections 138 to 148 lays down the provisions of "Penalties in case of dishonour of certain cheques for insufficiency of funds in the accounts".

2. Negotiable Instrument : Meaning & Definition

Meaning : The expression "Negotiable Instrument" means a piece of paper in writing entitling a right to the holder, a certain sum of money". It is a piece of paper, which contains some value and is transferable by simple delivery or sometimes by endorsement and delivery. According to Sec 13(1) of the Negotiable Instruments

Act, a negotiable instrument means a promissory note, bill of exchange or cheque. Under the Law of Negotiable Securities, an instrument possessing the quality of negotiability is entitled to be called a negotiable instrument.

Eg. Cheque, Demand Draft, Promissory Note, Bill of Exchange, Share Warrants, Dividend Warrants, Bearer Debentures etc.

According to Thomas an instrument is negotiable when

i) The instrument is freely transferable (by delivery or endorsement and delivery) either by application of law or by the custom of the trade concerned and

ii) Confers the privilege on the person who receives it bonafide and for value to possess good title thereto.

The Act states only three instruments – cheques, bills of exchange and promissory note- as negotiable instruments. Hence they are called negotiable instruments by statute.

Some other instruments have acquired the feature of negotiability by the custom or usage of trade. Section 137 of Transfer of Property Act, recognized that an instrument may be negotiable by law or custom. In our country therefore Government Promissory Notes, Shah Jog Hundis, Delivery Orders and Railway Receipts have been held negotiable by usage or the custom of trade.

There are several instruments which are not negotiable but can be transferred by delivery or endorsement and delivery. Yet they cannot confer a better title on the transferee than what the transferor has.

Definition : Negotiable Instrument has not been defined under the Negotiable Instruments Act. According to section 13 of the Act "a negotiable instrument means a promissory note, bill of exchange or cheque payable to order or bearer, whether the words order or bearer appears on the instrument or not".

In England Justice K.C.Wallis defines a negotiable instrument as "one, the property in which is acquired by anyone who takes it bonafide and for value, notwithstanding any defect of title of the person from whom he took it."

According to Bhashyam and Adiga (in his "Negotiable Instruments Act, 1881) " A Negotiable Instrument is one, which when transferred by delivery or endorsement and delivery passes to a transferee a good title to payment according to its tenor and irrespective of title of the transferor".

According to Thomas (in his Principles of Banking) " a Negotiable Instrument is one which is by a legally recognized custom of trade or law, transferable by delivery. In such circumstances that :

a) the holder of it for time being may sue on it in his own name and

b) the property in it passes free from equities, to a bonafide transferee for value, not withstanding any defect of the transferor ".

By observing the above definitions we can deduce the following features of Negotiable Instrument.

i) Negotiability

ii) It confers absolute and good title to the Transferee.

iii) the holder can recover the money with his own name and

iv) it consists of certain presumptions.

3. Features of Negotiable Instrument

Following are the characteristic features of the Negotiable Instruments –

i) Transferability

ii) Absolute Title and

iii) Right to Sue.

i) Transferability: The negotiable instruments are easily transferable from one person to another by mere delivery in case of a bearer instrument and by endorsement and delivery in case of an order instrument.

ii) Absolute Title: A negotiable instrument confers absolute and good title on the transferee, who takes it in good faith, even though the transferor has defective title. Such person (transferee) is called 'holder in due course' and his interest in the instrument is protected by law.

iii) Right to Sue: The holder of a negotiable instrument, who is legally called as 'holder in due course' has a right to sue upon the instrument in his own name.

4. Kinds of Negotiable Instruments

Following are the different kinds of negotiable instruments :

A) Promissory Note (Sec.4),

B) Bill of Exchange (Sec. 5) and

C) Cheque (Sec. 6).

A) Promissory Note (Section 4)

Definition : Section 4 of the Negotiable Instruments Act, 1881 defines promissory note as "an instrument in writing (not being a bank note or currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument". In short, it is called 'Pronote'.

The promissory note contains a promise or undertaking to pay a certain sum of money. The Act does not prescribe any particular form for a valid promissory note, but it is essential that it must satisfy the requirements of Section 4.

Essentials : A promissory note to be valid and enforceable, the following essentials are to be satisfied :

i) The promissory note must be in writing ;

ii) It must contain a promise/undertaking to pay certain sum of money ;

iii) The promise must be unconditional and certain ;

iv) It must be duly signed and delivered by the maker ;

v) The parties must be certain ;

vi) It must be stamped according to the provisions of the Stamp Act, 1940.

i) The promissory note must be in writing : Object of this requirement is to exclude oral engagements to pay from the purview of the Act. But it is immaterial whether the writing is in ink or in pencil. The term 'writing' includes printing, engraving, lithographing, typewriting etc. There is no prescribed form for validity of promissory note provided the requirements of the definition are complied with. Further the writing may be on any material – paper, parchment, account book, etc.

ii) It must contain a promise/undertaking to pay certain sum of money: It must not be a mere acknowledgement of debt without an express promise to pay. An instrument to be valid promissory note must have an undertaking to pay a sum. Thus the writing "I owe you Rs. 500", "I am liable to pay" or "I am bound to pay", constitutes only acknowledgements of liability to pay and cannot be treated or dealt with as promissory note.

I promise to pay Rs. 5000/- three months from this day to Mr. Manmohan or bearer or order for value received. This is the correct form of promissory note as it clearly expresses the promise to pay.

iii) The promise must be unconditional and certain : A promissory note must contain an unconditional undertaking to or

promise to repay. The payment of money should not be made to depend upon contingency, certainty is absolutely necessary in the commercial world. A conditional instrument will not be negotiable even after the fulfillment of the condition.

An instrument which contains, "I promise to pay C Rs. 100 on the 31st December, 1940, provided the war ends towards the end of November 1940", cannot constitute a promissory note, as it does not contain an unconditional undertaking to pay the sum mentioned therein. But a promise to pay B Rs. 500 one month after the death of C is a valid promise because death is a certainty. So it is an unconditional promise.

iv) It must be duly signed and delivered by the maker : The promissory note is incomplete without the signature of its maker. The object of the signature is to authenticate and give effect to the contract contained in the document. This signature can be made in any part of the document. This may be done even with a pencil. If the maker cannot write his name he may sign by thumb mark.

v) The parties must be certain : It is of utmost importance that the promissory note should point out with certainty the person who enters the contract and engages or undertakes to pay. Several persons may make a promissory note jointly and severally. Where a promissory note is drawn in the form "I promise to pay" and is signed by two or more persons it is deemed to be their joint and several note.

But a promissory note cannot be made in alternative form. Thus a promissory note running as "I.A.B. promise to pay" and signed by "A.B. or else C.D." is not a good note as regards C.D. but is a good note as against A.B.

vi) It must be stamped according to the provisions of the Stamp Act, 1940.

Specimen/Format of Promissory Note

(a) When promise is made to pay money on demand

Rs. 20000 Pune, September, 18, 2007

On demand, I promise to pay Sri. Gupta or order the sum or Rupees Twenty Thousand only for value received with interest at 12 per cent per annum.

To,

Sri. Gupta

148, Shivajinagar, Pune-01 **Stamp**

Sd. Ram

(b) Where promise to pay money after the expiry of a fixed time.

Rs. 20000 Pune, September, 18, 2007

Three months after date I promise to pay Sri. Gupta or order the sum or Rupees Twenty Thousand only for value received.

To,

Sri. Gupta

148, Shivajinagar, Pune-01 **Stamp**

Sd. Ram

B) Bill of Exchange (Section 5)

A bill of exchange is a written and signed order directing the person named in it to pay a certain sum of money only to, or to the order of a certain person or to the bearer. Bills of exchanges arise in business transactions. They normally arise when goods are sold on credit. The seller (creditor) draws bill on the buyer (debtor or buyer) to pay the amount specified in the bill of exchange normally after a specified period of time. The title of the bill of exchange can be transferred by endorsement and delivery/delivery or it can

be discounted with a banker. It can also be sent to a banker for collection.

According to Section 5 of the Act, "a bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only or to the order of a certain person, or to the bearer of the instrument".

In a bill of exchange one person makes an order to another person to pay a certain sum of money to someone. A bill of exchange is different from a promissory note in so far as in a promissory note there is a promise made by the maker of a promissory note to pay a certain sum of money whereas in a bill of exchange there is an order to pay. The other requirements in a bill of exchange are similar to those in the case of a promissory note. In a bill of exchange the order should be unconditional, it must be to pay money only, the sum payable should be certain, the instrument should be in writing and signed by the person who makes it and the payee should also be certain.

Where the instrument must be construed either as a promissory note or bill of exchange, the holder may at his election treat it as either, and the instrument shall be thenceforward treated, accordingly.

Essentials : Following are the essential elements of a bill of exchange.

i) It must be in writing.

ii) It must contain an order or undertaking to pay certain sum of money.

iii) The order to pay must be unconditional.

iv) There are three parties viz. Drawer, Drawee and Payee.

v) It must be signed by the drawer.

vi) The sum payable must be certain.

vii) It must be stamped according to Stamp Act, 1940.

Specimen/Format of Bill of Exchange

Rs. 25,000/- Mumbai, September 27, 2007

Three months after date pay to X or order the sum of Twenty Five Thousand Rupees for value received.

To, Z Accepted Sd/- Y Stamp

Z

Kinds of Bills of Exchange : The Bills of Exchange may be classified as follows:

i) Inland and Foreign Bills.

ii) Time and Demand Bills.

iii) Trade Bill and Accomodation Bill.

iv) Clean Bill and Documentary Bill.

Distinction between Promissory Note and Bill of Exchange : Despite many similarities, there are certain differences between the two as stated below.

Promissory Note	Bill of Exchange
i) There are two parties namely Maker and Payee.	i.) There are three parties namely, Drawer, Acceptor and Payee.
ii) The Maker of Pronote is Debtor	ii) The Maker is Creditor.
iii) Maker and Payee cannot be the same person.	iii) The Drawer and payee may be the Same person.
iv) It is an unconditional promise.	iv) It is an unconditional order.
v) Cannot be payable to bearer.	v) Can be payable to bearer.
vi) Pronote cannot be drawn in sets.	vi) Bill can be drawn in sets.

C)Cheque (Section 6)

Dr. Hart, in his Law of Banking defines a cheque as 'an unconditional order in writing drawn on a banker signed by the drawer, requiring the banker to pay on demand a sum certain in money to or to the order of a specified person or bearer and which does not order any act to be done in addition to the payment of money'.

A cheque is also a bill of exchange with two additional features:

i) It is always drawn on a specified banker.

ii) It is always payable on demand.

Section 6 of the Negotiable Instruments Act, 1881 defines cheque as "a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes electronic image of a truncated cheque and a cheque in the electronic form".

The definition of the cheque has been enlarged by the Negotiable Instruments (Amendment) Act, 2002 so as "to include electronic image of a truncated cheque and a cheque in the electronic form".

Cheque can be signed using digital signature and asymmetric crypto system.

A cheque is a bill of exchange with the following distinctive features :

i) It is always drawn on some bank. It means that the drawee of a cheque is always a bank.

ii) A cheque is always payable on demand. A bill of exchange other than a cheque may be either payable on demand or may not be payable on demand.

iii) After the amendment of the act in 2002, a cheque may also be in "electronic form".

Elements : Cheque is a special kind of bill of exchange, and the essentials of bill of exchange are also present in respect of the cheque. Further, to constitute cheque, the following conditions are to be satisfied -

i) It must be drawn on a specified banker, and

ii) It is always payable on demand.

Form of Cheque : A cheque can take the form of an order written on an ordinary piece of paper, but bankers usually insist upon the use of printed cheque forms supplied by them to their customers. A cheque is not invalid simply because it is made on an ordinary slip of paper, but usually the rules for opening an account specify that the customers should make use of printed cheque forms only. It is by virtue of such a rule that the banker would be justified in dishonouring cheques not drawn on the printed forms supplied to customers.

Specimen of Cheque

State Bank of India Main Branch, Eluru (A.P.)

Date: 15/01/2008

Pay to.....X.....or bearer/order Rupees.....Ten Thousand only.....

Rs. 10,000/-

A/c No..... Sd/- X

No. 690786

Cheques need not be stamped : In *C.T. Joseph v. I.V. Phillip (A.I.R. 2001, Ker. 300)* it has been held by the Kerala High Court that the cheques do not require any stamp under the Stamp Act. It has also been held that Section 20 of the Negotiable Instruments Act, which applies only to inchoate instruments, does not apply to cheques.

It may be noted that in practice in case of certain payments like payment through treasury such as Income Tax refund orders, it is insisted that there should be acknowledgement of receipt of the amount and the necessary stamp is also required on the back of the Refund Order.

Period of validity of a cheque : A cheque is valid for payment within a period of six months from the date on which it is drawn. According to the banking practice a cheque remains valid for payment for three months from the date on which it is drawn. Thereafter it becomes stale and then the drawee bank can refuse to pay the same.

Revalidation of stale cheque : A cheque which has become stale by the expiry of the period of validity can be revalidated by the drawer. A revalidated cheque gets a new lease of life and remains valid for the extended period of validity.

Validity of a post-dated cheque : In case of post dated cheque the period of validity is to be counted from the date which has been put on the cheque because that date is to be considered as the date of issue of cheque rather than the date on which the cheque has been drawn (*Shri. Ishar Alloys Steel Ltd v. Jayaswala NECO Ltd., AIR 2001 S.C. 1161*).

A post dated cheque is not a cheque on the date on which it is drawn. It becomes a cheque on the date written on it and till that date the instrument remains a Bill of Exchange *(Ashok Yeshwant Badave v. Surendra Madhavrao, AIR, 2001 SC 1315).*

For the purpose of offence of dishonour of cheque the pre-requisite is presentation of the cheque within 3 months from the date it is drawn. Thus, the period of 3 months for the post dated cheque starts from the date written on the cheque.

Distinction between bill of exchange and cheque

Bill of Exchange	Cheque
i) The drawee may be any person including	i) Drawee is always a banker. a banker.
ii) Acceptance of drawee is necessary.	ii) Not necessary.
iii) Notice of dishonour is necessary.	iii) Not necessary.
iv) Drawee is not entitled to any statutory protection.	iv) Drawee is entitled to Statutory protection.
v) Grace period of 3 days for payment is allowed.	v) No such grace period for Payment.
vi) It has to be stamped according to Stamp Act, 1940.	vi) Stamping is not necessary.
vii) No crossing is allowed.	vii) Different kinds of crossing is allowed.
viii) Payment of bill cannot be stopped or countermanded.	viii) Paymentof a cheque can be Countermanded.

5. Crossing of Cheques

Chapter XIV containing sections 123 to 131 of the Negotiable Instruments Act, 1881 lay down the provisions relating to crossing of cheques.

Cheques may be classified into two categories namely,

i) Bearer or open or counter cheques, and

ii) Crossed cheques.

Bearer cheque can be encashed directly through the counter while the crossed cheque can be cashed only through a bank account.

i) Bearer Cheque : The word 'bearer' is not defined in the Negotiable Instruments Act, but, the Bill of Exchange Act explains that 'bearer' means "the person in possession of a bill or note which is payable to bearer". It means, the instrument can be made originally payable to the bearer or it may be made bearer subsequently by holder making a blank endorsement. The bearer character of the instrument will not be lost, even in those cases where a bank endorsement is followed by full endorsement. The instrument continues to be transferable by mere delivery in all such cases (*Walker v. Macdonble (1948) 26. 527*). With regard to bearer cheques the rule is "once a bearer cheque always a bearer cheque". Where a cheque is originally expressed by the drawer himself to be payable to the bearer, the paying banker is fully protected if he makes the payment to the bearer or even if there is any forged or restrictive endorsement on the cheque. But the payment must be a payment in due course.

The banker is not required to verify endorsements on cheques drawn payable to bearer because a bearer cheque does not require endorsement for the purpose of negotiation but only delivery. However, in practice banks in India insist upon the presenter's signing the cheque presented over the counter before payment is made. Such a signature, besides operating as a receipt may even perhaps help the bank later in identifying the person to whom payment was made.

This principle of 'once a bearer always a bearer' has been introduced in Sec. 85(2) of the Negotiable Instruments Act by way of an Amendment to the Act in 1934. It says :

"Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the payee thereof, notwithstanding any endorsement whether in full or

blank appearing thereon. and notwithstanding that any such endorsement purports to restrict or exclude further negotiation".

The Mumbai High Court held that before the amendment was passed a bearer cheque could be converted into an order cheque by endorsement (*Dossabhai v. Virchand (1969) 21 Bom. A.G.*). C.J. and Kineain J. held that where a hundi was drawn in favour of a payee or bearer and the payee endorsed it to a named person. it ceased to be a bearer hundi and could be negotiated further only by the endorsee (*Forbes Cambell & Co. v. The official Assignee, Bombay (1925) 27 Bom. L.R. 34*). These two decisions have been nullified with the introduction of Sec. 85(2) in Negotiable Instruments Act by the Amendment of 1934.

Sec. 85(2) has no application to the i) Payment of a cheque which becomes bearer by a subsequent endorsement in blank, and ii) Payment of a customer's bill of exchange or promissory notes.

ii) Crossed Cheques : A crossed cheque is one which has two transverse parallel lines, marked across its face, with or without the words 'and company' or any abbreviation thereof. Crossing is an instruction from the drawer to the paying banker to pay the amount of a cheque through bank only and not directly to the person presenting it at the counter.

Crossing may be hand-written, stamped, printed or perforated. Crossing does not effect the negotiability of the instrument. Therefore, a crossed cheque is negotiable by delivery in case it is payable to bearer and by endorsement and delivery where it is payable to order. A crossed cheque can only be encashed through bank of which the payee of a cheque is a customer. The holder of a cheque who has no account can also obtain the amount by endorsing in favour of some person who has got an account with the banker. The relevant rules regarding the crossing are given under sections 123 to 131 of N.I.Act.

Kinds of Crossing : Crossing of cheques is of two kinds namely –

i) General Crossing ; and

ii) Special Crossing

i) General Crossing (Sec. 123) : Section 123 deals with "General Crossing". It runs as follows :

"Where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words "not negotiable", that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally."

General crossing consists in drawing of two parallel transverse lines on the face of the cheque. Sometimes, in addition to these lines, the words "and company" or '& co.' or 'Not Negotiable' or 'Account Payee' may be added as shown below :

Writing of two parallel transverse lines on the face of the cheque are essential for general crossing and the inclusion of words 'and company' or '& co. is immaterial. The lines should normally be drawn, across the middle of a cheque but sometimes they run across a corner, usually the left hand top corner. The Act is silent as regards the size of the lines or the distance between them.

ii) Special Crossing (Sec. 124) : Section 124 of the Negotiable Instruments Act, 1881 lays down the provisions relating to "Special Crossing". It reads as follows –

"Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable", that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker."

Special Crossing consists in writing, the name of the bank across the face of the cheque. In special crossing, the banker on

whom it is drawn shall pay it otherwise than to the banker to whom it is crossed or his agent for collection. Specimen of special crossing is given below :

Section 126 of the Act imposes an obligation on the paying banker to make payment against crossed cheques. Otherwise he is liable under section 129 of the Act. Further, he loses statutory protection available to paying banker under section 128.

A special crossing requires the name of the banker to be written across and on the face of the cheque. The two parallel transverse lines are not necessary for a special crossing although they are usually drawn, or also the words '& Co.' or their abbreviations since special crossing itself specifies the name of the banker.

A cheque crossed specially will be paid only when it presented by the bank named between the parallel lines. The banker to whom the cheque is specially crossed, may appoint another banker as his agent for collection of such cheques. Thus, a special crossing makes the cheques still more safe.

Who may cross a cheque (Sec. 125) : A cheque may be crossed either by the drawer or by the holder. Section 125 permits the crossing being made in the following ways by the holder :-

(i) Where a cheque is uncrossed, the holder may cross it generally or specially.

(ii) Where a cheque is crossed generally the holder may cross it specially.

(iii) Where a cheque is crossed generally or specially the holder may add the words "not negotiable".

The banker also is entitled to cross a cheque in the name of another bank who may collect the cheque as an agent for collection. Therefore, where a cheque is crossed specially, the banker to whom it is crossed may cross it specially to another banker, his agent for collection (Section 127).

Protection to the "Paying Bank" (Sec. 128) : The relation between a banker and his customer is that of a debtor and a creditor. Banker does not enjoy the position of a trustee of the money deposited with him by the customer. Money deposited will always belong to the customer and the bank will be bound to return its equivalent to the customer or to any person to his order on demand. Section 31 of the Negotiable Instruments Act provides "the drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque must pay the cheque when duly required to do so, and in default of such payment, must compensate the drawer for any loss or damage caused by such default." Thus a banker should be very cautious both at the time of honouring as well as dishonouring his customer's cheques.

The paying banker shall ensure that the cheque which is presented for payment is in order in all respects before making payment of cash. Secs. 126, 127 and 129 of the Negotiable Instruments Act lays down the duties of paying banker as regards to crossed cheques.

Sometimes the collecting bank may collect the cheque for a person who is not actually entitled to receive the payment. The paying bank may not be aware of the fact and the responsibility of the paying bank ends when it makes the payment to the collecting bank because the collecting bank is in a better position to know as to for whom the collection is being made. According to section 128 when the paying bank, i.e. that bank on whom the crossed cheque is drawn makes the payment of the cheque in due course it is deemed to be valid payment as if the payment had been received by the true owner of the cheque. The protection is available to the paying bank only if the payment has been made in due course, as defined in section 10 i.e. the payment in good faith, without negligence, according to the apparent tenor of the negotiable instrument. Thus, if the paying bank makes the payment of an "Account Payee"

cheque to the collecting bank on an endorsement by the latter bank stating "payee's account credited", the paying bank is protected under section 128, even if the collecting bank negligently credits the account of a person other than the payee (*Anupama Stationery v. Vishnuvardhana Enterprises, (1987) 62 Comp. Cas. 271(Karn)*.

If the drawee bank makes payment out of due course then it would be liable for the loss suffered by the true owner of the cheque (section 129). For example, if a cheque is crossed generally and the bank makes the payment at the counter or it is crossed specially to a particular bank and the payment is made to another bank, such payment is not in accordance with the apparent tenor of the cheque and it is not a payment in due course. In such a case the drawee bank can be held responsible for any loss which the true owner might sustain owing to the cheque having been so paid.

Precautions to be taken by a Paying Banker : The paying banker, while honouring the cheques shall take the following precautions –

i) The cheque should be in proper form. The Negotiable Instruments Act does not give the form of a cheque but most banks in India provide in their rules of operating accounts that the cheque must be drawn in the printed forms supplied by the banks and the banks reserve the right of dishonouring a cheque in case it is not in the prescribed form.

ii) The most important precaution that a banker should take is about crossed cheque. A banker has to verify whether the cheque is open or crossed. He should not pay cash across the counter in respect of crossed cheques. If the cheque is a crossed one, he should see whether it is a general crossing or special crossing. If it is a general crossing, the holder must be asked to present the cheque through some banker. It should be paid to a banker. If the cheque bears a special crossing, the banker should pay only to the bank whose name is mentioned in the crossing. If it is a open cheque, a banker can pay cash to the payee or the holder across

the counter. If the banker pays against the instructions as indicated above, he is liable to pay the amount to the true owner for any loss sustained. Further, a banker loses statutory protection in case of forged endorsement.

In ***Madras Bank Ltd Vs. South India Match Factory Ltd.***, a cheque was issued by a purchaser in favour of the official liquidator of a company towards the purchase price of certain properties. The bank paid the amount of the crossed cheque to the liquidator across the counter. The Liquidator mis-appropriated the amount. In a suit filed, the court held that the "banker committed breach of statutory duty and was negligent in paying direct to the liquidator over the counter and hence was not entitled to legal protection."

iii) He must verify that whether the cheque presented for payment is properly dated. If it is undated or postdated or stale(i.e. dated earlier than 6 months), he should dishonour the cheque.

In case a banker honours a post-dated cheque, it runs the following risks :

a) The drawer may countermand the payment before the date mentioned on the cheque and then the banker will not be entitled to debit the customer's account with the amount of the cheque.

b) The drawer may make the banker liable for dishonouring of other cheques on account of insufficiency of funds resulting because of payment of the post-dated cheque.

c) In case of insolvency or death of the drawer before the date mentioned on cheque, the banker shall not be entitled to debit the customer's account, if it has already made payment of the cheque.

d) The payment of a post-dated cheque shall not be considered to be a payment in due course and, therefore, the banker shall not be entitled to any statutory protection if the payment is made to a wrong person.

iv) The banker should see that the amount mentioned both in figures and words in the cheque are the same. In case they differ, the amount stated in words may be taken as correct and the banker returns the cheque for reference to the drawer. In case the amount has been stated in words only and not in figures the banker should pay the cheque. But where the amount has been mentioned in figures only, not in words, the banker should return the cheque.

v) There should be sufficient funds in the account of the customer for payment of the cheque. Cheque has to be paid in full and not in part and, therefore, inadequacy of funds will result in dishonour of the cheque unless the banker has granted loan or advance to the customer to that extent or more than the amount of deficit.

vi) He must check the drawer's signature got tallied with the specimen signature of the drawer in the bank records.

vii) He should pay during banking working hours open to the public.

viii) He should dishonour the mutilated cheques (i.e. cheque, which is torn into two or more pieces).

Protection to the "Collecting Bank" (Sec. 131) : A banker is under no legal obligation to collect cheques and bills on behalf of its customers. But every modern bank collects cheques and bills on behalf of its customers in order to provide a service to them. This service of collection of cheques on behalf of its customers has become an accepted part of banker's functions, due to greater use of crossed cheques, which are payable through a banker only. When a banker undertakes to collect cheques and bills, he is called "collecting banker". In the process of collecting cheques the banker acts as a (i)holder for value, (ii) as an agent of the customer. A collecting banker has certain duties and responsibilities in collection of cheques for his customer.

Section 131 of the Act grants a protection to the collecting bank. If the collecting bank has collected a cheque satisfying the conditions which are mentioned in Section 131, then it cannot be held liable even if the amount is collected on behalf of a person who is not the true owner. In order to avail of such a protection the banker has to prove the following:

(i) That the banker had received the payment as a crossed cheque. It means that the cheque which is to collect must have been given to the banker as crossed i.e., which was crossed either generally or specially to that banker before it reached the hands of the collecting bank.

(ii) That the collection was made by the bank on behalf of a customer. It is however immaterial that the bank may credit the customer's account before the amount is collected.

(iii) The collecting bank must have acted in good faith and without negligence in collecting the amount due on the cheque. If there are circumstances which can arouse a suspicion in the mind of a collecting bank regarding the rights of a person who wants to get the cheque collected the bank is supposed to make proper inquiries before collecting the cheque. If the bank fails to make any such enquiry, it is not acting in good faith.

(iv) It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the prima facie genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care.

In ***Anupama Stationery v. Vishnuvardhana Enterprises (1987) 62 Comp. Cas. 271 (Karn.)***, the collecting bank collected a cheque marked "payee's account only" by making an endorsement, "payee's account credited". It however, negligently credited the account of a person other than the payee. The collecting bank was held liable to pay damages to the drawer of the cheque.

If the bank is negligent in opening the account in a fictitious name, and is subsequently negligent in collecting the cheque/draft, the bank cannot claim the protection under Section 131.

In ***Syndicate Bank v. Jayshree Industries (AIR, 1994 Kant. 315)***, a draft in the name of 'Ms. Rama' was collected and credited to the account of 'Mr. Rama', the bank was held to be negligent and thus not entitled to protection given under Section 131, N.I. Act. It is no defence that the bank acted in good faith.

Negligence in collecting a Bank Draft or a cheque includes, negligently opening a Bank Account of a person and then collecting his Bank Draft negligently for him.

6. Parties to the Negotiable Instrument

A negotiable instrument is transferable from one person to another. The Negotiable Instruments Act 1881 confers upon a person who acquires the instrument bonafide and for value, the right to possess good title to the instrument., Such a person is called 'holder in due course'. Each and every person in possession of a cheque or bill can not be holder in due course and therefore cannot claim statutory protection under the Act. If the instrument falls into wrong hands, the holder cannot enjoy the privileges of a holder in due course. The parties to the Negotiable Instrument may be explained with reference to the following heads -

A) Holder (Sec. 8)

B) Holder in Due Course (Sec.9)

C) Payment in Due Course (Sec. 10)

D) Drawee in case of Need

E) Holder for value.

A) Holder (Sec. 8)

Holder (Section 7) : According to section 8 of the Negotiable Instruments Act, 1881 the "holder of promissory note, bill of exchange

or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto."

In simple words, holder means 'owner of the negotiable instrument'. A person to be a holder must satisfy the following conditions :

i) He should be entitled in his own name, to the possession of the instrument; and

ii) He should have the right to receive or recover the amount due thereon from the parties thereto.

In case of bearer instrument, the possessor is the holder while in the case of an instrument payable by order, the payee is the holder.

If a person is entitled to the possession of a negotiable instrument in his own name he will be the holder. What is required is a right to possession. A person in possession of an instrument without having a right to possess the same cannot be called the holder. Thus, a thief or a person taking a negotiable instrument by forged endorsement or a person finding an instrument on the road, although may be having a de facto possession but he cannot be called the holder, because his possession is wrongful and he is not entitled to the possession of the negotiable instrument. Similarly, if I deliver a negotiable instrument to my servant for safe custody he does not become the holder because he is not entitled to the possession in his own name. Holder, therefore, means only a "De Jure holder" and not merely a "De facto holder".

When a negotiable instrument is originally made, the payee is the holder of the same. If the payee transfers his rights to another person then the transferee becomes the holder in place of the payee. In the case of a Bearer instrument the transferee to whom the negotiable instrument is delivered is known as the 'Bearer' of the instrument and such transferee (bearer) is the holder. In the

case of an order instrument the instrument is transferred by an endorsement and delivery to the endorsee, in such a case the 'endorsee' becomes the holder. Thus, the term holder would include the following :

i) The Payee.

ii) The Bearer (i.e. the transferee of a bearer instrument), or

iii) The Endorsee (i.e. the transferee of an order instrument).

B) Holder in Due Course (Sec.9)

A holder in due course is in a privileged position and has a good title, though the transferor has a defective title.

According to section 9 of the Negotiable Instruments Act, 'holder in due course' means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order before the amount mentioned in it became payable (and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived the title).

Example : When a person has obtained a negotiable instrument by theft of fraud or for an unlawful consideration, the title of the person having such possession is defective. If he transfers it to a holder in due course, the title of the holder in due course is good. If he further transfers, such transferee's title also is good. Therefore, according to section 36 of the Negotiable Instruments Act, every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied (prior party in the sense, maker of promissory, drawer of bill of exchange or cheque, the drawee or acceptor of a bill and endorsers of the instrument)

Conditions : A person to be a holder in due course, the following conditions are to be satisfied.

i) He must have received the instrument for a valuable consideration.

ii) The instrument should be obtained before its maturity.

iii) The instrument should be complete and regular on its face.

iv) He should have taken the instrument in good faith (without the knowledge of defective title).

Rights and Privileges : The Negotiable Instruments Act, confers on the holder in due course, the following rights and privileges:

i) A holder in due course, prima facie must be a holder of the instrument for a valuable consideration. It is an execption to the maxim "nemodat quod non-habet."

ii) Section 58 provides another privilege to a holder in due course. When a negotiable instrument has been lost or has been obtained by a person by means of an offence, say theft, or by fraud, or for an unlawful consideration, a person having such a possession of the instrument cannot claim any right in respect of any amount due on the negotiable instrument. But if such an instrument is transferred to a person as a holder in due course, he will get a good title. A transferee from holder in due course also gets a clean title as that of the holder in due course himself.

iii) Another privilege of a holder in due course, as stated in section 120, is that no maker of a promissory note, and no drawer of a bill of exchange or cheque, and no acceptor of a bill of exchange for the honour of the drawer, shall, in a suit thereon by a holder in due course, be permitted to deny the validity of the instrument as originally made or drawn.

iv) Section 121 provides another privilege of a holder in due course. No maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due

course, be permitted to deny the payee's capacity at the date of the note or bill, to endorse the same. Against a holder in due course the maker of a promissory note and the acceptor of a bill of exchange are estopped from denying the payee's capacity to endorse the negotiable instrument. Thus, the maker of a promissory note will not be allowed to say that the payee of the note was an insane person and, therefore, the endorsee from him, who is a holder in due course, could not get a good title. There is, however, nothing which can prevent the maker or acceptor to challenge the rights of the endorsee on the ground that the payee's endorsement was forged, as the forged endorsement does not convey a good title even to a holder in due course.

Difference between holder and holder in due course : Following are the notable points of difference between holder and holder in due course.

i) In case of holder, the existence of consideration is not essential. But it is essential in case of holder in due course (the holder in due course obtains the instrument after paying its full value)

ii) The most important point of difference is, the interest of the holder in due course is protected though the transferor has defective title. Such protection is not available to holder.

C) Payment in Due Course (Sec. 10)

Meaning : Payment against negotiable instrument (cheque/ bill etc.) should be made to the right person by the banker (or acceptor of the bill). The payment is said to be in due course provided it is made under section 10 of the Negotiable Instruments Act. The Act provides protection for such payment (i.e. payment in due course).

The paying banker can claim protection only if the payment constitutes payment in due course which is defined by Section 10 of

the Negotiable Instruments Act as follows : " Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not receive payment of the amount therein mentioned."

Definition : According to Section 10 of the Negotiable Instruments Act, "Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without any negligence to any person in possession thereof under circumstances, which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned."

According to Sec. 10, payment is said to be a payment in due course, when the banker makes such payment under (good faith) a belief that the person (payee) is a bonafide holder and that there is no circumstance to believe that he is making such payment negligently.

Essential Features : A payment to be a payment in due course, the following conditions are to be satisfied.

i) It(the payment) should be made in accordance with the apparent tenor i.e. in accordance with intention of the parties.

ii) It should be made in good faith and without any negligence.

iii) It should be made to the person in possession of the instrument without any suspicion as to title.

Following payments are not payments in due course :

i) Payment of crossed cheque against counter (like a bearer cheque);

ii) Payment against post dated cheque;

iii) Payment against forged instrument;

iv) Payment against cheque containing alteration and corrections.

D) Drawee in case of Need

The drawee in case of need is a person whose name is added to the bill of exchange apart from the drawee, to whom the resort may be had in case of need i.e., the Bill being dishonoured by non-payment or non-acceptance.

Section 115 of the Act says that the Bill is not dishonoured unless it is dishonoured by the drawee in case of need. So in case of need, it is the duty of the holder or payee to produce it to drawee in case of need.

In English law he is called referee in case of need. Similar provision is also provided in English Law under Section 15 of Bills of Exchange Act.

E) Holder for value

The term holder for value is not defined under the Negotiable Instruments Act. According to Sec. 27(2) of the Bills of Exchange Act, (England), where value has at any time been given for a bill, the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to such time.

Whenever the value of the instrument is guaranteed to any holder, he is called holder for value. No consideration is needed i.e. a person who claimed to be a holder, need not be given value, it may be given by a prior party.

Eg:- 'P' the payee of a bill, transfers (endorses) it to 'E' for value. 'E' again transfers it to 'F' without consideration. In this example 'F' is the holder for value. (The transferee/endorsee of an instrument without consideration/value is called the holder for value).

7. Endorsement (Negotiation of Negotiable Instruments)

Section 15 of the Negotiable Instruments Act says : "When the Maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for purposes of negotiation, on the back or face thereof, or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same and is called the indorser." Endorsement(Indorsement) is a form of 'negotiation'. Before explaining in detail about the Endorsement, it is necessary to know in brief about the 'negotiation' as follows :

NEGOTIATION : Meaning : Transfer of an instrument from one person to another (so as to make the transferee a holder) is called 'negotiation'. In other words, when the holder of a negotiable instrument, i.e., the person who is entitled to receive its payment transfers the negotiable instrument to another person so that the transferee now becomes entitled to receive the payment, the instrument is said to be negotiated.

According to Section 14 of the Negotiable Instruments Act, "when a promissory note, bill of exchange or a cheque is transferred to any person, so as to constitute that person, the holder thereof, the instrument is said to be negotiated."

Kinds of Negotiation : Negotiation is of two kinds as follows:

i) Negotiation by simple delivery (Sec. 47)

ii) Negotiation by Endorsement (Sec. 48)

i) Negotiation by simple delivery (Sec. 47) : Bearer instruments are transferable from one person to another by simple delivery. It is, however, necessary that the delivery of the negotiable instrument must have been made with an intention to transfer the ownership, i.e. constitute the transferee as the holder of the instrument, as required by Section 14.

ii) Negotiation by Endorsement (Sec. 48) : Endorsement means 'signing the instrument', otherwise than as maker for the purpose of negotiation. Endorsement may be made on the very face of the instrument or on the backside or in a slip annexed to the instrument. The person who endorses is called 'Endorser' and the person to whom it is endorsed is called 'Endorsee'.

Object of Endorsement : The following are the objects of endorsement.

i) At the time of endorsement the endorser has a good title to the instrument.

ii) The instrument is a genuine one.

iii) All prior endorsements are genuine and regular.

iv) The instrument will be duly paid at maturity.

Who may Endorse and Negotiate (Sec. 51) : Every sole maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees, of a negotiable instrument may endorse and negotiate the same unless the negotiability of such instrument has been restricted or excluded as mentioned in Section 51. It is, however, necessary that such maker or drawer who wants to endorse the instrument is in lawful possession of the instrument, or the payee or endorsee who wants to endorse is the holder of this instrument.

Features of Endorsement : Following are the features of Endorsement.

i) There is no proper procedure to be followed.

ii) Endorsement may be either on the face of the instrument or on backside of it or in a separate sheet (allonge).

iii) It requires the signature of the holder or his agent.

iv) The payee or the holder must sign in his exact name.

v) Endorsement should be by pen only.

vi) It need not contain any complimentary words.

vii) An illiterate can also endorse by thumb impression.

viii) An endorsement is presumed to have been made in the order in which it appears.

ix) Endorsement should be for full value.

x) If married woman endorses then her husband's name is also to be included.

xi) The endorsement will be completed by delivery.

xii) In case of signing on behalf of the holder or as an agent, it should make clear by adding the words for or on behalf of.

xiii) It can be endorsed any number of times.

Kinds of Endorsement : Endorsement of an instrument can be made under the following ways :

i) Endorsement in Blank or General Endorsement (Sec. 16(1);

ii) Special Endorsement or Endorsement in full (Sec. 16(1);

iii) Conditional Endorsement (Sec. 52);

iv) Restrictive Endorsement (Sec. 50);

v) Sans recourse Endorsement (Sec. 52); and

vi) Contingent Endorsement.

i) General Endorsement (Sec. 16(1) : If the endorsement is made by signature of the endorser without any direction to whom it is endorsed, it is called endorsement in blank or general endorsement.

ii) Special Endorsement (Sec. 16(1) : If the endorser specifies the name of the person to whom it is endorsed, it is called special endorsement.

iii) Conditional Endorsement (Sec. 52) : The endorsement is subject to happening of certain event.

iv) Restrictive Endorsement (Sec. 50): It is a particular type of conditional endorsement. In this case, the endorser by express words restricts the right of endorsee for further endorsement.

v) Sans recourse Endorsement (Sec. 52) : Sans recourse means without recourse or without liability. In this case, endorser is not liable in case, the instrument is dishonoured.

vi) Contingent Endorsement : If the liability of the endorser is subject to the happening of a contingency (uncertain event) it is called contingent endorsement.

8. Assignment and Negotiation

The expression assignment literally means 'transfer'. According to section 130 of the Transfer of Property Act, every actionable claim can be transferred by means of a separate instrument in writing duly stamped and signed by the transferor. Negotiable instruments are also actionable claims, and hence can be assigned.

Distinction between 'Assignment' and 'Negotiation' : Despite many similarities, following are the differences between assignment and negotiation.

Assignment	Negotiation
i) It is effected under Transfer of Property Act, 1882.	i) It is effected under Negotiable Instruments Act, 1881.
ii) It requires written document duly signed	ii) It can be effected by simple by the transferor. Delivery or endorsement.
iii) Defective title of the instrument affects the assignee.	iii)Defective title of the instrument does not affect holder in due course.

9. Kinds of Cheques

Cheques may be classified into the following kinds-

i) Stale Cheque or Out-dated cheque.

ii) Ante-dated Cheque.

iii) Mutilated Cheque; and

iv) Post-dated Cheque.

i) Stale Cheque or Out-dated cheque : A cheque to be honoured, it has to be presented within 3 months from the date of the cheque. If the cheque is presented for payment beyond the 3 months, it is said to be the Stale or Out-dated Cheque. However, an out-dated or Stale cheque may be accepted by the banker for payment if the drawer/customer gives consent to make the payment. Such consent is subject to the period of limitation, which is 3 years. In other words, the drawer of the cheque has to give his consent within 3 years. The period of limitation is 6 years in England.

G. Balakrishna v. The Official Assignee, Madras & others : It was held in this case that if a cheque is presented beyond 6 months, the holder of the cheque cannot have recourse to the drawer and is not entitled to claim payment against such cheque.

ii) Ante-dated Cheque : A drawer while drawing cheque gives the date in that cheque prior to the date on which it is drawn (prior to the date means back date). It is called ante-dated cheque. Banker can accept such cheque, if it does not exceed 6 months period.

iii) Mutilated Cheque : A cheque which is cut into many pieces is called mutilated cheque. The drawee bank should see in honouring a cheque, whether it is mutilated, cancelled or torn. If the cheque is torn into two or many pieces, it should be returned with the remark 'mutilated cheque'. If he is satisfied that the mutilated cheque gets the original shape of the instrument, he may accept the cheque.

In *Scholey v. Ramsbottom (1810)*, a cheque was torn into four pieces and thrown away and new cheque was drawn which was paid. The torn cheque thereafter presented neatly pasted, though dirty and the drawee bank paid the same. It was held that the drawee bank cannot debit the second cheque because it was dirty and torn.

In *Hongkong & Shanghai Banking Corporation v. Loo Lee Shi (AIR 1928 P.C.)*, it was held that if a cheque is torn accidentally either by the drawer or by the holder, the drawer must confirm it.

iv) Post-dated cheque : Drawer of a cheque gives the date in the cheque later or after the date on which it is drawn. It is known as post-dated cheque. The banker must accept the post-dated cheque only after the ostensible date given on the cheque. If he accepts before, he has to face many consequences.

10. Marking of Cheques

The expression 'Marking of Cheque' denotes "certification of cheque by an authorized person in a bank". The authorized person in the bank certifies the cheque by writing on the face of the cheque, "Approved" or "Good for Payment" and then signs on the cheque.

Effect of Marking : By way of marking, it is implied that at the time of marking, the cheque has satisfied all its requirements and it is properly submitted and also that the customer is having sufficient amount in his account to meet this cheque.

Who can mark the cheque ? : Only a banker can mark the cheque.

Who can request the banker to mark the cheque ? : The following persons are entitled to request the banker to mark the cheque.

A) Marking at the instance of the drawer or customer.

B) Marking at the instance of the holder.

C) Marking by the Banker.

A) Marking at the instance of the drawer or customer : When the banker marks the cheque with the request of the customer, then it is called marking at the instance of the customer. If it is a marking at the request of the customer, the banker must keep some amount separately for the purpose of meeting this marked cheque whenever it is presented because it amounts to constructive payment.

B) Marking at the instance of the holder : When the banker marks the cheque with the request of the holder, then it is called marking at the instance of holder. It is merely certifying the cheque. There is no obligation to the banker to keep the money for this cheque.

C) Marking at the request of a Banker : It is common that one banker may also request another banker for marking the cheque when he thinks so. It does not mean that the banker who marked the cheque is completely liable over the cheque. It only means that at the time of marking, the cheque is 'good for payment'. So in this type of marking, the collecting banker generally presents the cheque for collection immediately.

Marking of Post dated cheque : Marking of post dated cheque is dangerous to the banker. The marking of general cheque certifies that at the time of marking the cheque is 'good for payment' and it may be accepted within a reasonable time. The important case on marking of post-dated cheque is, ***Punjab National Bank v. Bank of Baroda (1914, P.C. 58)***

In this case a post-dated cheque for Rs. 2,75,000/- drawn on Bank of Baroda, Calcutta Branch was marked as 'good for payment' on the request of Punjab National Bank. Punjab National Bank paid the entire money to his customer before the ostensible date and cheque was sent for collection on the ostensible date to Bank of Baroda. Bank of Baroda rejected the payment. Punjab National

Bank challenged the significance of marking, however, it was held that Bank of Baroda was not responsible to pay the post-dated cheque and the following aspects are also observed in this case.

a) Cheque is special bill of exchange which needs no acceptance.

b) Both M.Chalmers and Sir John Paget are of the opinion that Marking or certification, neither in form nor in effect, may be deemed an acceptance of which the holder or payee can avail himself of.

c) Both in England as well as in India marking is judicially recognized only for clearance purposes.

d) Marking is deemed as a gentleman's agreement or honourable obligation, which has no validity in Law.

e) There is no custom or usage which impose responsibility on the marked bank.

f) There is no promise made by Bank of Baroda to Punjab National Bank with regard to the payment.

g) Marking of post-dated cheque generally will not give any liability to the drawee bank, and

h) The manager of Bank of Baroda was not ostensible authority to mark the cheque.

11. Material Alteration

What is Material Alteration : Any alteration made in the instrument which affects the legal validity of the instrument or which changes the rights and responsibilities of the parties to the instrument, is called material alteration.

What is the effect of Material Alteration : Sec. 87 of the Act states as follows :

"Any material alteration of negotiable instrument renders the same void as against any one who is party thereto, at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties.

And any such alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof."

The provisions of this section are subjected to those of sections 20, 49, 86 and 125.

What are the instances of Material Alteration : The following are the instances of material alteration.

i) Alteration of date

ii) Alteration of time

iii) Alteration of place

iv) Alteration of amount

v) Alteration of parties

vi) Alteration of rate of interest

vii) Converting order instrument into bearer instrument

viii) Affixing more stamps to the instrument.

Alteration not vitiating the instrument : The following alterations are not considered as material alteration.

i) If it is made before issuing.

ii) If it is done for the purpose of correction.

iii) If it is made to carry on the intention of the drawer.

iv) If it is done with the consent of the parties, and

v) Where it is immaterial alteration.

Alteration Authorised by Law : The following alterations are authorized by law and they cannot be considered as material alteration.

i) Filling the blanks in inchoate instrument(Section 28).

ii) Converting blank endorsement into special endorsement (Section 49).

iii) Crossing of Cheque(Section 125).

Banker's responsibility over the materially altered cheques :

Section 89 protects the interest of the paying banker when he pays the amount over the materially altered instruments. However, material alteration discharges the liability of the banker over the cheques. He can reject the payment over the instruments materially altered. If banker pays the amount over materially altered instruments, his interest would be protected provided the following conditions are satisfied.

i) When such alteration is not apparent.

ii) When the banker has made the payment in due course; and

iii) When the banker is liable to that cheque.

However, whether the instrument is altered or not that is a question of law decided by the court, which depends much upon the circumstances of each case. The following are some of the cases in this regard.

***Tanjor Permanent Bank Limited v. S.R. Rangachari* (AIR 1959 Mad. 119) :**

In this case the statutory protection was rejected to the paying banker because of the fact that the alterations were material and apparent and were not authorised by the drawer.

Brahma Shum Sher Jung Bhadar v. Chartered Bank of India, Australia and China **(AIR 1956 Cal. 399):**

Here paying banker obtained the statutory protection because the alteration was not apparent. It was held that the instrument on its face did not disclose any trace of alteration therefore the drawee bank was entitled for a statutory protection.

Dick Joice v. The Bank of India Ltd **(1933 suit No. 548/ 1932 Sm.cc Court, Bombay) :**

In this case a cheque was altered materially by a chemical process in every part except the drawer's signature and such alteration was not apparently clear. When cheque was presented it was duly paid by the banker in good faith and without negligence. It was held that the bank was entitled to statutory protection under sec. 89 of the Negotiable Instruments Act because the alteration was not apparent and effected in due course.

However, customer must also take reasonable care over the instrument. He should not allow any person by his negligence to alter the instrument. If it is there, he has to bear the loss caused to him due to any alteration. The following are some of the cases in this regard :

Young v. Grote **(1827, 4 bing 253) :**

In this case, Young gave his wife five cheques signed in blank to be used by her for his business as and when necessary. Mr. Young gave one of the cheques to a clerk to be filled up for Rs. 50-2-3. The clerk filled it in such a way that he would alter the amount both in words and figures to Rs. 350-2-3. The alteration was so made that it could not be detected. It was held that the customer acted negligently and therefore had to bear the loss. This decision was reversed in Colonial Bank of Australia v. Marshall (1906, A.C. 549) and decision was given in favour of the customer.

***London Joint Stock Bank v. Macmillan & Arthur* (1918, A.C. 77) :**

In this case, the decision of *Young v. Grote* was confirmed again. In this case a clerk in the firm of Macmillan & Arthur prepared a cheque for 2 pounds with space left before and after 2 pound, and with no amount written on the body of the cheque. After obtaining the signature of the partner in the firm, the clerk altered the amount to 120 pounds. He then encashed the cheque at the counter and absconded. It was held that the banker was entitled to debit the customer's account with 120 pounds because the alteration was not apparent and the customer, by his carelessness in drawing the cheque had facilitated the alteration.

The Statutory Protection over the materially altered instrument is recognized in England under Sections 64 and 68 of Bills of Exchange Act. By observing the above aspects we can say that the statutory protection is recognized to the paying banker in many sections either in England or in India provided the payment amounts to the payment in due course.

12. Forgery of Drawer's Signature (Payment of forged cheque)

While opening an account with the bank, the customer is required to give/supply to the banker, this specimen signature. The general rule is that the banker is expected to be familiar with the signature of his customer. If the signature is forged, the banker should not honour the cheque. If he honours, he cannot debit the customer's account with the amount so paid. Therefore, the paying banker must be very careful while comparing the signature on the cheque with the specimen signature. The signature must be on the face of the cheque. In case, the drawer changes his signature and communicates the same to the banker, it is effective from the date specified therein.

A cheque with forged signature is a nullity and the banker has no obligation to make payment. Payment against forged cheque is deemed to be a payment without authority of the customer, and it amounts to breach of implied contract between the banker and the customer. Further, the paying banker is not given any statutory protection. The banker bears the liability even if the drawer's signature is so cleverly forged and the same could not be detected despite reasonable degree of care and scrutiny. The banker is liable, even if the drawer (customer) was negligent in keeping the cheque book under lock and key as laid down by the ***Allahabad High Court in L.P.Dayal v. Jwala Bank ltd.***

The Supreme Court in –***Bihta Co-operative Development and Cane Marketing Union Ltd vs. Bank of Bihar Ltd.***, held that leaving cheque book carelessly by the customer affords no defence to the bank.

Obligation on the part of customer : The customer has the following obligations to protect the banker from forged cheques:

i) He has an obligation to keep the cheque book under lock and key and must communicate to the banker in case the cheque book or leaves therein is lost/found missing.

ii) If the customer is doubtful that a cheque with forged signature is going to be presented for payment, he must inform the banker immediately.

iii) If the customer fails to inform about the above forged cheques, the banker loses his right against the forger and the customer is estopped from denying the genuineness of his signature.

Exceptions : The above general rule that the customer's account cannot be debited in respect of payment against the forged cheque is subject to the following exceptions.

i) Contributory Negligence : It means both parties (i.e. banker and customer) contributed for the negligent act i.e. payment

against the forged cheque. In other words, both the banker and the customer are responsible. If the customer is guilty of contributory negligence, his account can be debited with the amount paid against the forged cheque.

ii) Misleading : If the customer by his conduct misleads the bank so that the payment is made against the forged cheque, the banker affords defence to debit the customer's account.

13. Notice of Dishonour

What is Dishonour ? : When a promissory note or bill of exchange or cheque is rejected by the drawee for payment, then it amounts to dishonour of the instrument. –

Types of Dishonour : Dishonour is of two types .

i) Dishonour by non-acceptance and

ii) Dishonour by non-payment.

i) Dishonour by non-Acceptance (Sec. 91) : The following are the instances which amounts to dishonour by non-acceptance.

a) When drawee refuses to accept

b) When drawee becomes incompetent

c) When drawee gives qualified acceptance

d) When drawee's present is excused.

ii) Dishonour by Non-Payment : It is common for every instrument when any person in the negotiable instrument fails to pay the money to the person entitled in it, then it amounts to dishonour by non-payment.

Whenever any negotiable instrument is dishonoured, a notice on the part of that claimant is necessary. It is nothing but to warn the drawee or other persons for its dishonour. So notice of dishonour should be served to the parties responsible in the instrument.

Notice by Whom : By holder or by any person who is entitled to get the money.

Notice to Whom : Notice should be given to dishonoured persons generally, but sec.94 says that notice should be given to :

i) Authorised agent to whom it is required to be given.

ii) Legal representative, when the drawee or endorsee has died.

iii) Official Assignees or Receiver, when the party to whom the notice is required to be given has been declared as an insolvent.

Effects of omission to give notice : Secs. 38 and 35 of Negotiable Instruments Act require the notice of dishonour to the endorsee as well as endorser respectively without which they are not responsible.

Mode of Notice : There is no proper procedure for Notices. It may be oral or in writing. Only thing required here is the information should reach the responsible person.

14. Criminal Liability of the Drawer of a cheque (Cheque Bouncing)

Till recently, the drawer of a cheque was subject to civil liability only in respect of the money due on a cheque, if it was dishonoured for reasons whatsoever. With the enforcement of Banking, Public Financial Institutions and Negotiable Instrument Laws (Amendment) Act, 1988 on April 1, 1989, dishonour of cheques because of insufficiency of funds, is now deemed as an offence for which the drawer may be punished with imprisonment for a term up to two years or with fine up to twice the amount of the cheque or with both. Such a punishment will be in addition to his liability in a civil suit. Sections 138 to 148 which have been inserted in the newly added Chapter XVII to the Negotiable Instruments Act, 1881 provide for conditions, procedure and punishment for criminal liability of the drawer.

Sections 138-148 deal with the following aspects :

a) Dishonour of cheque for insufficiency of funds etc. (Sec. 138)

b) Presumptions in favour of holder (Sec.139)

c) Defence which may not be allowed in any prosecution under Sec. 138(Sec. 140)

d) Offences by Companies (Sec. 141)

e) Cognizance of Offence (Sec. 142(1)).

(f) Jurisdiction of Courts (Sec. 142(2)) & Sec. 142A)

(g) Power of Court of try cases summarily (Sec. 143)

(h) Power to direct interim compensation (Sec. 143A)

(i) Mode of service of summons (Sec. 144)

(j) Evidence of the complainant may be given by him on affidavit (Sec. 145)

(k) Bank's slip or memo is *prima facie* evidence of certain facts (Sec. 146)

(l) Offences Punishable under this Act shall be compoundable (Sec. 147)

(m) Power of Appellate Court to order payment pending appeal against conviction (Sec.148)

The following aspects are generally covered under Chapter XVII of the Act for fixing the criminal liability of the drawer :

a) The cheque has been issued in discharge of a debt or other liability in whole or in part.

b) The cheque should be presented to the paying banker in time i.e. within 6 months or its specific validity period, whichever is earlier.

c) The dishonour of cheque should be on account of insufficiency of funds only – either the amount of money standing to the credit of the account is insufficient or that the amount of cheque exceeds the amount arranged to be paid from that account by an agreement with the bank.

d) The payee or holder in due course should give notice in writing to the drawer demanding payment within 30 days of his receiving information of dishonour.

e) The drawer can make payment within 15 days of the receipt of the notice, if he fails to do so, prosecution can take place.

f) The complaint can be made within one month of the cause if action arising (i.e. expiry of 15 days time given to the drawer to make payment)

g) No court lower to that of metropolitan Magistrate or Judicial Magistrate of 1st class will try the offence.

Section 140 makes it quite clear that the drawer of the dishonoured cheques cannot defend himself on the ground that he had no reason to believe when he issued the cheque that the cheque may be dishonoured or presentation on account of insufficiency of funds.

If the dishonoured cheque is drawn on behalf of a company, a firm or association of individuals every person who was in charge of and was responsible to the company or the firm for the conduct of its business, at the time the offence was committed, and also the company shall be deemed to be guilty of the offence. But if any such person proves that the offence was committed without his knowledge or that he had exercised all due deligence to prevent the commission of such an offence, he will not be liable for punishment (Section 141 of the Act).

Clarifications :

a) Complaint is to be lodged with **criminal court** and not with **police** (Sec. 142 C)

b) The cheque should pertain to the DEBT or other liability which is alive and not barred by limitation (Sec. 138 C).

c) Complaint is to be lodged against the person who has issued the cheque. If cheque is issued by a company, then "person" means "every person who is responsible for the conduct of the business of company" (Sec. 140).

15. The Paying Banker (Statutory Protection to the Paying Banker)

Paying Banker : Paying Banker, in the simple sense means the banker, who makes payments against his customers' cheques. A Banker has a statutory obligation to honour customer's cheques. Payment of cheques involves great risk, since the banker is liable for wrongful dishonour. In order to minimize such risks and losses to paying banker, the Negotiable Instruments Act, 1881 provides statutory protection to him.

Risks not covered/protected under the Act : There are certain risks incurred by a paying banker, for which statutory protection is not available under the Act.

i) Forgery of drawer's signature and

ii) Fraudulent alterations of the cheque such as alteration of the amount, payee etc.

Protection in case of Order Cheques (Sec. 85(1) : Where a banker makes payment against an order cheque with forged endorsement, the drawee (paying banker) is discharged from liability. After insertion of Sec. 16(2) this protection is extended to other endorsements also. To avail the statutory protection under section 85(1) the following two conditions are to be satisfied :

i) The endorsement must be regular, and

ii) The payment must be in due course (i.e. U/s.10)

United Bank of India v. A.T. Ali Hussain & Co.(AIR 1978 Cal. 169) : The plaintiff paying banker made payment of Rs. 5200/- against a forged cheque to A.T.A. H.Co. through their banker Union Bank of India. It was found that the forgery could not be detected even by authorised signatory (A/c holder) or trained expert. Calcutta High Court granted protection to the plaintiff bank.

Protection in case of Bearer Cheque (Sec. 85(2) : According to Sec. 85(2) the paying banker is not required to verify the regularity of endorsements on bearer cheques. In such cases, the banker is discharged from the liability. Even if the banker makes payment against stolen bearer cheque, he is discharged from liability.

Protection in case of crossed cheques (Sec. 128) : Section 128 protects paying banker in case of payment against crossed cheques. Crossing of cheques denotes payment in accordance with the instruction of the drawer. The protection under section 128 is available if the following two conditions are satisfied :

i) If the payment is made in due course U/s. 10 and

ii) Such payment is made in accordance with the requirement of crossing under sec. 126 i.e. through any banker in case of general crossing and through the particular banker in case of special crossing.

Exceptions : The protection U/s. 128 is not available to paying banker in the following cases :

i) If the payment against crossed cheque is made in case there is irregular endorsement, or

ii) If there is a material alteration on the cheque, or

iii) Forged signature of the drawer.

Liability of paying banker : The paying banker is under statutory obligation to honour his customer's cheques. Otherwise, he is liable under section 31 of the Act to compensate the drawer (customer) for any loss he may suffer. This duty/liability under section 31 of the Act is subject to the fulfillment of the following conditions :

i) There must subsist the banker and customer relationship, i.e. the account must not have been closed.

ii) The customer must have sufficient funds to honour the cheque.

iii) The banker is under obligation to pay the cheque "only when duly required to do so". It means (i)the cheque is presented in the branch, where his account is kept, (ii)it is presented during banking hours, and (iii) the funds are properly applicable to the cheque.

Liability for wrongful dishonour : If the paying banker wrongfully dishonours a customer's cheque, he is liable for damages to the customer.

16. The Collecting Banker (Statutory Protection to the Collecting Banker)

Collecting Banker : Collecting banker is one, who in discharge of agency services, collects cheques/bills of exchange etc., on behalf of his customers. Collection of cheques involves great risk and hence the collecting banker has been provided statutory protection under the Negotiable Instruments Act, 1881 (Section 131).

Conditions : A collecting banker is entitled to statutory protection, provided the following conditions are fulfilled.

i) The cheque must be a crossed cheque;

ii) The payment must be received for a customer ;

iii) The payment must be received in good faith and without any negligence.

i) The Cheque must be crossed : The collecting banker gets statutory protection in case of crossed cheques only. The crossing may be general or special. Otherwise, he is liable for conversion, defective title (of the cheque) etc. (Sec. 128). Section 131-A extends this protection to crossed bank drafts also.

ii) Collection for customer only : The statutory protection is available to the collecting banker if he collects the cheque as an agent of the customer, not as a holder for its value (holder for value means when a customer presents an outstation cheque for collection and the banker gives immediate credit to his customer's account without waiting for its clearance, then the position of banker is holder for value). A customer is one, who has an account with the banker and his dealings with the banker in the nature of banking business.

iii) In good faith and without negligence : The collecting banker is entitled to avail statutory protection when he receives payment in good faith and without negligence. A thing is deemed to be in good faith when it is done honestly.

Conversion : Section 131 affords protection to collecting banker, that he is not liable to the true owner for conversion even though his customer's title to the cheque proves defective provided the following conditions are satisfied :

i) It is a crossed cheque;

ii) he has received payment as an agent for collection, and not on his own behalf as a holder;

iii) he has collected the cheque for a customer in good faith and without any negligence.

17. Closing of a Bank Account

The relationship between a banker and a customer exists/ begins by opening of an account. This relationship extents (comes to an end) when the account is closed. The proposal to close the account may come from the customer or banker. When the customer requests the bank to close his account, it is referred to (called) as 'Closing an Account'.

Similarly, when the banker takes initiative to close the account, it is referred to as 'stopping of account'.

Closing an Account : When a customer requests the banker in writing to close his account, the banker is bound to close the same. He(banker) should not ask the reasons and the customer is required to return the unused cheques.

A customer may get his account closed by withdrawing the balance standing to his credit or liquidating the outstandings in his account. An account cannot be treated as closed even if it shows 'nil' balance, until and unless the customer's request/direction to that effect has been received. The account may be closed even if the unused cheques are not returned. However, efforts should be continued to recover unused cheque leaves.

Stopping an account : A banker may take steps to stop his customer's account, which is found to be undesirable. The banker must give due notice to the customer, of his intention to close the account and request him to withdraw the balance standing to his credit. The banker takes such extreme step to stop his customer's account under the following circumstances :

i) Mis-use ;

ii) Un-operated account ;

iii) Insanity of customer ;

iv) Insolvency of customer ;

v) Death of customer ;

vi) Garnishee order ; and

vii) Assignment.

i) Mis-use : When the customer is guilty of misusing the account viz. forging cheques, bills of exchange, issuing cheques without sufficient balance, failure to pay back (repay) loans, overdrafts etc.

ii) Un-operated account : When an account of his customer remains un-operated for a long time, the banker may presume that

he needs no longer the account and communicate him to withdraw the amount. Despite reasonable efforts, if the customer has not been traced, the banker may transfer the balance at his credit to an 'unclaimed deposit account' and the account is closed. The balance shall be paid to the customer, as and when, he is traced.

iii) Insanity of customer : When a banker receives notice regarding insanity of his customer, he has to stop payments against the account.

iv) Insolvency of customer : If the customer becomes insolvent, he is deprived of operating the account. The banker has to transfer the balance (standing to customer's account) to the Official Receiver of the insolvent customer.

v) Death of customer : When the customer dies, the banker must stop operation of his customer's account.

vi) Garnishee order : When the banker receives a Garnishee Order from the court, he is bound to suspend the operation of his customer's account.

vii) Assignment : Assignment simply means transfer, when the banker receives a notice of assignment of the credit balance of his customer's account to a third party, the banker is bound to pay/ transfer the same to such third party.

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